

Competition Update
March 2009

OLSWANG



Contents



1. Introduction
2. The EU Court of First Instance dismisses Intel's appeal against the European Commission's procedural decisions in its Article 82 investigation
3. The European Commission's approach to State aid in the banking sector
4. European Commission accepts divestiture commitments following Article 82 investigation as E.ON agrees to open the German electricity market to competition
5. Competition Commission orders BAA to sell three major airports, and urges overhaul of the airport regulatory system - drastic remedies in the absence of 'guilt'?
6. High Court decision in *Cityhook* maintains wide discretion for regulators over how to prioritise their caseload
7. Recent case law developments in public procurement
8. Cartel round-up

Introduction



It is with great pleasure that we bring you our first Competition Update, in which we intend to provide a quarterly update on key developments in competition law.

These are momentous times for the global economy. Governments, regulators, commentators and the public alike are fundamentally questioning how we regulate our economic activities. Competition law is only one form of such regulation, but it has already been plunged into the furnace of the economic turmoil – witness the waiving of competition concerns over Lloyds TSB's acquisition of HBOS in the UK.

We therefore examine here the European Commission's approach to assistance measures for the banking sector. While Commissioner Kroes has lived up to her 'Nickel Neelie' moniker in her steely assertion of the continued primacy of competition law, this has not precluded flexibility in the Commission's response to the crisis.

On the European front, we feature two Article 82 investigations by the Commission; the first involving Intel's unsuccessful procedural complaint to the CFI, and the second discussing the unprecedented divestment commitments given in the E.ON investigation. We also round up the latest developments in European cartel enforcement, where the Commission's work continues apace.

A UK parallel to the E.ON divestments is found in the Competition Commission's order for airport operator BAA to divest half of its airport capacity. The contrasting approaches to market failure are fascinating. While E.ON's divestments result from a specific *infringement* investigation (albeit an actual infringement finding was averted), BAA has been subject to sanctions following a *sectoral* market investigation in which it was not even accused, let alone found culpable, of any infringement. The draconian remedy has real ramifications for other sectors in the UK which may be prone to scrutiny.

We feature a couple of other UK developments which may be of wider interest. First, the judicial review of the OFT's decision to drop the Cityhook collective boycott investigation sheds light on the right of regulators to prioritise their caseload. Second, a number of interesting public procurement cases have recently been heard in the UK. These may well have wider application.

Of course, the usefulness of the Competition Update will benefit hugely from the feedback of our readers. If you do have any thoughts or comments on the content in this edition, we are always grateful to receive them. Please contact me or any of my colleagues listed at the back of this edition.

Howard Cartlidge



The EU Court of First Instance dismisses Intel's appeal against the European Commission's procedural decisions in its Article 82 investigation

In the Commission's long-running investigation of alleged anti-competitive practices by Intel, Intel appealed to the EU Court of First Instance ("CFI") against two procedural decisions of the Commission: (i) its refusal to order Intel's rival, AMD, to provide certain documents to the investigation, and (ii) its rejection of Intel's submission that time for responding to the Commission should run from the time it received those documents. The CFI held that these decisions could not be annulled, being procedural decisions which did not have binding legal effects independent of the main decision in the investigation. Further, the CFI can only annul a Commission decision, not substitute its own decision in its place.

Background

Following a complaint by AMD, Intel's major rival in the Central Processing Unit ("CPU") market, since 2004 the European Commission has been investigating potential breaches of Article 82 by Intel in relation to its pricing and marketing of x86 CPUs. The Commission issued a statement of objections ("SO") to Intel in 2007, and a supplementary statement of objections ("SSO") raising new allegations in July 2008.

In parallel, AMD has also launched civil proceedings against Intel in Delaware, on largely similar grounds. During these parallel proceedings, AMD and Intel have become aware of documents held by each other which are of potential relevance to the European investigation.

The decisions being appealed

The decisions appealed by Intel related to the Commission's procedural conduct of the Article 82 investigation. As a result of the Delaware litigation Intel knew of a number of documents held by AMD, which Intel believed could help it to rebut the SSO. Intel therefore demanded that the Commission order AMD to provide these documents to the investigation. However, when the Commission finally did so, it only required the provision of those documents *which could be precisely identified* from Intel's list. Consequently, only seven documents were provided by AMD.

Intel therefore asked the CFI to annul the Commission's decisions which: (i) ordered AMD to produce only those documents which could be precisely identified; and (ii) rejected Intel's submission that its time for responding to the SSO should run from the date it received the requested documents. Intel also asked the CFI itself to extend the deadline for response to the SSO to 30 days from the date on which Intel gained access to the requested documents.

Request for the CFI to set a new deadline for response to the SSO

The CFI gave this request short shrift. Intel's application on this matter was *"prima facie manifestly inadmissible ... it is not for the Community judicature, in an action for annulment of a decision taken by an institution, to issue directions to that institution ... it is solely for that institution whose decision was*

annulled to adopt measures to comply with the judgment annulling that decision." In other words, while the Community courts are entitled to review and to overturn decisions of the institutions, they are not entitled to substitute their own decisions in their place.

Annulment of the decisions

The more significant aspect of the judgment deals with Intel's request for annulment of the Commission's decisions. The CFI stated that *"only a measure whose legal effects are binding on the applicant and are capable of affecting his interests, by bringing about a distinct change in his legal position, is an act or decision which may be the subject of an action for annulment."* That is, in general a mere procedural decision cannot be annulled, as it produces only preliminary effects which have no impact until a finding is made in the main investigation. Only a measure which immediately and irreversibly affects the applicant's legal situation, in this case a finding of infringement of Article 82, can justify annulment.

This does not mean that procedural decisions are not open to challenge. It simply delays any challenge until the Commission makes a final, binding decision which negatively affects the applicant – in this instance (hypothetically) a finding as a result of the investigation that Intel has infringed Article 82. The CFI was very clear that at such a point Intel would be entitled to bring an action for annulment of the final decision on the basis of the Commission's procedural illegality. However, *"it is in principle only those measures which definitively determine the position of the Commission upon the conclusion of that procedure which are open to challenge and not intermediate measures whose purpose is to prepare for the final decision."*

However, the CFI noted an important distinction between Intel's application and a situation where a party is ordered to provide documents, which may involve loss of confidentiality or privilege. This has binding legal effects on that party which are independent of the issues in the main investigation. The loss of confidentiality or privilege becomes irreversible and affects the party immediately, not on the culmination of the investigation, and therefore the affected party may bring an action for annulment of the measure.

Implications of the judgment

From one point of view, the CFI's judgment could be interpreted as a robust response to procedural roadblocks in an already long-running investigation (AMD made its initial complaint to the Commission in 2000). The Commission has unsurprisingly welcomed the judgment. Notwithstanding this, some of Intel's arguments are worthy of note – especially the points that the effective refusal of early access to documents: (i) may hamper Intel in defending itself against the allegations in the SSO; and (ii) creates serious cost implications by unnecessarily prolonging the investigation.

The judgment should not be interpreted to give the Commission procedural *carte blanche* in any investigation. The CFI's judgment is very clear as to the consequences of procedural illegality, which may vitiate the entire procedure: *"Intel could obtain the annulment of the decision and, if the conditions were fulfilled, obtain damages for the harm suffered as a result of the Commission's conduct."* It also notes, sagely, that the Commission may yet choose to *"rectify any procedural irregularities"*.

The reality is that the Commission will be taking immense care in its approach to the investigation – if a finding of abuse against Intel is ever made, an appeal by Intel is very likely in view of this prior action for annulment. The Commission has been careful to leave the door open to the possibility of further documents being required from AMD, and to further time extensions for Intel.

The European Commission's approach to State aid in the banking sector

The financial crisis has prompted a large number of State aid notifications to the European Commission concerning measures to prop up the ailing banking sector. The Commission has set out its approach to the State aid rules in the banking sector in various guidance documents.

Background

Article 87(1) of the EC Treaty prohibits aid granted by an EU Member State or through State resources which "*distorts or threatens to distort competition by favouring certain undertakings*". Member States may grant State aid only if it falls within an exemption under Articles 87(2) or 87(3) and has received the approval of the European Commission. Otherwise, the Commission can rule that the incompatible aid must be recovered from the beneficiary.

Where the government of a Member State proposes measures to support institutions in its national financial market, it must notify the Commission prior to their implementation. Alternatively, the Member State may seek confirmation that the proposed aid satisfies the market economy investor principle ("MEIP") (i.e. a normal market economy investor would have acted in a similar way in equivalent circumstances) or is otherwise essential to fulfil a broader legitimate economic objective, and is therefore not deemed to be State aid.

The Commission has applied two exemptions to the various proposed rescue schemes:

- Article 87(3)(b) exempts aid to remedy a serious disturbance in the economy of a Member State (known as the **serious disturbance exemption**).
- Article 87(3)(d) exempts aid to facilitate the development of certain economic activities where such aid does not adversely affect trading conditions to an extent contrary to the common interest (known as **rescue and restructuring aid**).

The Commission published guidance in October last year explaining that the seriousness of the crisis makes the serious disturbance exemption available (albeit only for as long as the crisis situation justifies its application). It is a reflection of the gravity of the crisis that this is only the fourth occasion on which the Commission has applied the serious disturbance exemption (it previously having been used only during the recession of the mid 1970s, and twice in Greece).

How has the Commission applied the exemptions?

The Commission's involvement in the review of State aid to banks began in 2007 with its approval of emergency measures for banks including Northern Rock in the UK. At the time of writing, the Commission had considered over 40 notifications of various measures to be implemented by Member States in order to stabilise financial institutions and the markets. The Commission has also published a series of documents providing a framework for the application of the State aid rules to measures proposed by Member States to deal with the financial crisis.

1. *Banking Communication (October 2008)*

This applies the State aid rules to measures taken in relation to financial institutions, and:

- sets out guidance on the criteria for assessing compatibility of general schemes, as well as individual cases of application of such schemes and *ad hoc* cases of systemic relevance. In line with the general principles underlying the State aid rules, measures must be well-targeted, proportionate to the challenge faced, and designed to minimise spill-over effects on competition, other commercial sectors and other Member States;
- sets out the criteria the Commission will apply when assessing various aid measures to financial institutions, including guarantees covering their liabilities, their recapitalisation, their controlled winding up, and other forms of liquidity assistance; and
- asks Member States to notify proposed measures to the Commission as early and as comprehensively as possible. The Commission generally reaches a decision on proposed aid within 20 days of notification, but in response to the crisis it has committed to make decisions within 24 hours or over a weekend if necessary – a commitment it has been required to meet on a number of occasions.

2. *Recapitalisation Communication (December 2008)*

This Communication responds to requests for detailed guidance, from both Member States and potential beneficiary institutions, on the acceptability of specific forms of recapitalisation. The Commission notes that it became necessary to publish this additional guidance because the nature, scope and condition of recapitalisation schemes being envisaged varied considerably.

The Commission notes that recapitalisation has three main objectives: (i) to restore financial stability by rebuilding confidence in inter-bank lending and limiting the risk of banks becoming insolvent; (ii) ensuring lending to the real economy; and (iii) responding to the problems of financial institutions facing insolvency as a result of their particular business model or investment strategy. In order to address potential competition concerns the Commission will seek firstly to ensure fair competition between Member States and between banks at a national level, and secondly to ensure a return to normal market functioning.

The Commission advocates that any recapitalisation scheme should take the market situation into account (i.e. the bank's risk profile and level of insolvency) and maintain a level playing field by not providing large subsidies compared to current market alternatives. Further, pricing conditions should provide an incentive for the bank to redeem the State aid as soon as the crisis is over.

3. *Temporary Framework (December 2008)*

As the downturn has hit the economy as a whole, Member States have increasingly found it necessary to develop economic stimulus packages. The Commission has been keen to avoid uncoordinated intervention which could distort competition between Member States. The Temporary Framework is designed to assist companies whose problems are a direct result of the economic downturn, as opposed to companies whose problems pre-date 1 July 2008.

The Temporary Framework describes the types of measures which will be considered compatible with the State aid rules. It effectively provides a safe harbour for common forms of measures, including lump sums of aid of up to €0.5 million per company, state guarantees for loans at a reduced premium, subsidised loans for businesses, and interest rate reductions on investment loans for the production of green products.

At the end of February the Commission published an additional Communication amending the Temporary Framework to clarify that such measures must be necessary, appropriate and proportionate to remedy a serious disturbance in the economy, and that the conditions in the Temporary Framework must be observed. The amendment also modifies the loan guarantee conditions and revises the 'safe harbour' provision.

4. *Communication on the Treatment of Impaired Assets (February 2009)*

This Communication deals with relief for so-called "toxic assets". The Commission notes that asset relief may provide various benefits, in particular by directly addressing uncertainty regarding the quality of bank balance sheets, and reducing the risk of repeated rounds of recapitalisation as the extent of asset impairment increases amid a deteriorating economic situation.

In order to minimise the risk of a recurrent need for State interventions for the same beneficiaries, the following criteria are a prerequisite for asset relief: (i) applications should be subject to full disclosure of impairments by eligible banks prior to government intervention; and (ii) an application for aid should be followed by a full review of the bank's activities and balance sheet with a view to assessing its capital adequacy and future viability. Impaired asset relief programmes should have an "enrolment window" limited to six months from the launch of the scheme. This will encourage banks to make the necessary disclosures of toxic assets and to facilitate a rapid resolution to the banking problems.

The Commission also notes that access to asset relief should be conditional on behavioural constraints including safeguards to ensure that capital is used for providing credit to meet demand according to commercial criteria without discrimination. The Commission also advises that restrictions on dividend policy and caps on executive remuneration should be considered.

On the road to recovery?

It remains impossible to predict both how the financial crisis will develop and what the Commission's approach will be in the coming months and, potentially, years. However, the number of Commission decisions approving State aid in the banking sector appears to have peaked at the end of 2008 (35 decisions were published in the last quarter of 2008) and has tailed off this year (at the time of writing only nine applications had been approved in the first quarter of 2009 and a further three cases were pending approval). However, each of the schemes approved must be reviewed every six months and the first wave of reviews will commence in April 2009. The Commission will therefore have little opportunity for a rest.

Commissioner Kroes has publicly stated that, since the crisis began, the Commission has "*learned a lot, and improved the design of the measures very much through a trial-and-error process*". This admission indicates how the Commission has sought to work closely with Member States to find solutions. The Commission is to be commended for its efforts over recent months to avoid economic meltdown by addressing problems as they have arisen.

The Commissioner has also expressed her view that serious restructuring will be needed by the end of 2009 and that banks will need to be subject to stricter governance in the future. It will, of course, be for the individual governments to decide on how the sectors are regulated. However, those Member States seriously affected by the current financial crisis will be keen to avoid any further bail-outs or repeated rounds of recapitalisation.

European Commission accepts divestiture commitments following Article 82 investigation as E.ON agrees to open the German electricity market to competition

Following its investigation into a potential breach of dominant position by E.ON in the German electricity markets, the European Commission accepted commitments by E.ON to address its concerns by selling off parts of its electricity generation and transmission system. This is the first time the Commission has accepted structural, rather than behavioural, commitments to resolve a non-merger competition investigation. It represents a victory for the Commission over national governments and incumbents in unbundling electricity networks.

Background

In 2006, the European Commission carried out dawn raids at the premises of a number of European energy companies, including E.ON. Subsequently, it opened an investigation into E.ON's activities in the German electricity wholesale and balancing markets. The Commission's preliminary opinion was that, under Article 82 of the EC Treaty, E.ON might have abused its dominant position in these markets in the following ways:

Electricity wholesale

The Commission defined electricity wholesaling as the import and generation of electricity for further resale. In the Commission's view, E.ON was jointly dominant in this market with RWE. In its preliminary assessment, the Commission raised concerns that E.ON had a strategy to withdraw available generation capacity by limiting the production of certain plants, with a view to increasing electricity prices, to the detriment of final consumers. The Commission also raised concerns that E.ON had developed a strategy to deter entry by third parties into the wholesale generation market in Germany. This, the Commission said, could be through the establishment of long-term supply agreements, or by offering potential new competitors a participation in an E.ON power plant.

Electricity balancing

Unlike the wholesale electricity market, in which electricity is purchased for resale, balancing power is needed to maintain the appropriate tension levels in the grid. The Commission was concerned that E.ON was increasing its own costs by systematically sourcing balancing power from its own production affiliate, rather than procuring it from other, cheaper, sources. E.ON, the Commission believed, then passed on these additional costs to the final consumer. The Commission also believed that E.ON had rejected approaches from generators in other Member States to provide balancing energy.

Commitments by E.ON

Under Article 9 of Regulation 1/2003, the Commission may decide to accept binding commitments from companies that are being investigated for a breach of competition law, where it would otherwise be minded to make an infringement decision under Article 81 or 82. After deciding to accept commitments, the Commission can then close its investigation without reaching a final decision, but with the benefit of a legally enforceable undertaking which resolves its competition concerns. A further benefit is that the Commission is able to divert its attention and resources to tackling other investigations.

Although E.ON did not accept the Commission's preliminary assessment that it might be in breach of Article 82, in February 2008 the Commission announced that E.ON had offered commitments to divest specific parts of: (i) its generation capacity (to resolve concerns on the wholesale market); and (ii) its transmission system business (to resolve concerns on the balancing market). After seeking comments on the proposed commitments, the Commission announced on 26 November 2008 that it had decided to accept and make binding the undertakings offered.

Previously, the Commission has accepted undertakings in eight investigations. Significantly, however, the undertakings agreed in these cases were behavioural. For example, companies undertook to limit the duration of their supply agreements, or to supply technical information to competitors, with third party monitoring to ensure compliance by the parties concerned. The E.ON case marks the first occasion on which the Commission has accepted structural undertakings (i.e. divestments) to resolve its concerns pursuant to a competition investigation. A significant benefit of this type of commitment is that, once the divestments have been completed (in accordance with the conditions put in place by the Commission regarding the identity and financial strength of the buyers of the divested assets) no monitoring is required. Further, the Commission of course has vast experience of managing divestiture situations through its merger control work.

Significance for liberalisation

The offer by E.ON of these structural commitments was seen as a significant victory for the Commission in its battle with the German and French governments to force national energy champions, such as E.ON and EDF, either to sell off their power transmission assets to keep them separate from energy production, or to leave the management of their power transmission assets to independent operators. According to the Commission's proposals in its third energy liberalisation package of 2007 (unveiled pursuant to the Commission's 2005 energy sector inquiry, which identified a lack of unbundling between network and supply interests as a serious barrier to competition in electricity and gas markets), where a company sells wholesale electricity and also owns the transmission networks, it has every incentive to prevent competitors from accessing its grid. Such a market structure allows energy producers to maintain high prices, and discourages potential competitors from investing in new infrastructure, knowing that market incumbents rely solely on their own affiliates.

The German government had criticised the Commission's proposed liberalisation package, arguing that such unbundling would endanger the quality and security of Germany's electrical power networks. Having initially stood alongside the German government on the issue, E.ON has subsequently stated that its undertakings to the Commission will encourage competition in the German electricity markets, to the benefit of consumers. Commissioner Kroes has agreed with this, commenting that E.ON will no longer be able to favour its own production affiliate over its competitors – a change which should ultimately result in a reduction of electricity prices. In October 2008 the EU's energy ministers held discussions on the liberalisation package, and at the time of writing a compromise had reportedly been reached on the issue of unbundling. An additional option has been agreed under which a trustee can be appointed in order to ensure that the management of a vertically integrated company's supplier and transmission system operator are kept separate. This compromise would suggest that EU governments are now resigned to the fact that unbundling is going to be forced upon them, one way or another.

Further, at the time of writing the Commission had just accepted a commitment offered by RWE to divest its entire West German high-pressure gas transmission network in order to address the Commission's concerns that RWE may have abused its dominant position by restricting competitors' access to its

transmission network. Like E.ON, RWE had initially staunchly opposed the Commission's calls for the unbundling of major energy suppliers.

While these two cases represent the first occasions on which the Commission has accepted structural undertakings in order to resolve concerns arising from a non-merger competition investigation, the Commission has previously accepted other competition-related undertakings in the liberalisation of certain market sectors. For example, in the 1996 *Atlas* decision, the Commission granted individual exemption from the competition rules to a telecommunications joint venture in return for specific commitments from the parties, on the grounds that the joint venture would help to liberalise telecommunications services in France and Germany. The increasing number of sector inquiries carried out by the Commission – the current investigation into the pharmaceutical industry being a high profile current example – reflects the Commission's growing determination to identify barriers to competition within specific industries. This is likely to be the catalyst for the increasing use of structural remedies to resolve competition issues in those industries.

Competition Commission orders BAA to sell three major airports, and urges overhaul of the airport regulatory system - drastic remedies in the absence of 'guilt'?

The UK Competition Commission ("CC") has ordered unprecedented divestments to address competition problems following a market investigation. BAA, the former State-owned airport operator, has been ordered to sell three airports, amounting to almost half of its capacity. This is a draconian remedy in the absence of any infringement of competition law by BAA, with serious ramifications.

The market investigation regime under the Enterprise Act 2002 is not primarily designed to find a particular operator 'culpable'. Indeed, the statutory remit for the CC to investigate whether features of a market (as opposed to the behaviour of operators within it) adversely affect competition recognises that not all market failures are the result of anti-competitive behaviour, nor are they all curable by conventional competition law tools. In that context, forcing BAA to sell three airports raises the spectre of reduced valuations for companies in other sectors that might be subject to market investigations by the CC in the future.

"Competition" in the airport services market includes passengers and airlines switching between airports, and competition in services and facilities such as quick turn-around for low-cost airlines. The CC found that such competition is adversely affected by, for example, the UK planning system and government policy, which constrain airport capacity and therefore the ability of airports to compete. However, (i) the common ownership by BAA of certain airports, and (ii) the system of regulation in the airport sector were also found to have adverse effects.

BAA's common ownership of airports adversely affects competition

The CC found that common ownership by BAA of particular airports adversely affects competition, i.e. under separate ownership there would be potential for competition. BAA owns airports handling 62% of UK airline passenger traffic. However, its share is much greater in certain regions – 92% of passenger traffic in south-east England (where it owns Heathrow, Gatwick, Stansted and Southampton), and 90% in Scotland (where it owns Glasgow, Edinburgh and Aberdeen). The CC identified in BAA airports in these regions "a *lack of responsiveness to the interests of airlines and passengers that we would not expect to see in a well-functioning market*". It noted factors such as:

- the significant levels of competition between airports, including much higher levels of airport development, in regions where BAA's share of traffic is lower, such as the Midlands and the north of England;
- the rapid growth of Prestwick as a competitor to Glasgow and Edinburgh airports, manifest in a certain amount of price competition between them;
- competition in London between Luton and Stansted, when they had spare capacity; and
- evidence of significant substitutability of passenger demand between BAA's London airports, suggesting the possibility of competition outside common ownership.

Other effects of BAA's common ownership

BAA argued that the possibility of competition from other airports require its airports to have spare capacity. The lack of available capacity in the UK was CC attributed by the CC variously to the planning system, Government policy, and the regulatory system. BAA argued that, particularly in south-east England, capacity has been constrained to the extent that airports in the region could not compete even were they separately owned – that is, the adverse effects on competition were systemic features, rather than attributable to BAA.

However, the CC attributed such capacity constraints partly to BAA itself – BAA's common ownership of the three major London airports disincentivised not only 'traditional' service-based competition, but also competition between them to develop new capacity. The CC pointed to BAA's history of lobbying for a new runway at Heathrow, but not at Gatwick – *"separate owners of Heathrow and Gatwick would have behaved differently, and ... a separate owner of Gatwick could have seen the capacity constraints at Heathrow as an opportunity for nearby airports."* Further, while BAA pointed to Government policy as a constraint on capacity, the formulation of that policy was due in part to the significant influence of BAA itself, which had consistently argued that no new runway capacity was needed.

Malfunctioning regulatory regime

The CC acknowledged that, at over 20 years of age, airport regulation is one of the oldest economic regulatory systems in the country. However, (perhaps as a result) the CC believed that the regulatory system is itself a feature adversely affecting competition, owing to:

- the over-focus of the sectoral regulator, the CAA, on its statutory duty to impose the minimum restrictions consistent with its functions (contrast this with the 'softer', principle-based commitment to 'light touch' regulation by regulators such as Ofcom);
- the distortion of the CAA's duty to further the reasonable interests of users, focusing on passengers rather than airline users;
- the absence of any statutory obligation on the CAA to promote effective competition;
- the lack of binding obligations on BAA, whether under statute or licence;
- the absence of any system of appeal other than judicial review in the High Court;
- the CAA's only means to encourage investment being its setting of maximum airport charges on a 5-year basis; and
- distortions of investment incentives caused by the RPI-X RAB-based regime.

Remedies

The CC's decision that BAA should sell three of its airports – Gatwick, Stansted and either Edinburgh or Glasgow – is its first use of its power to order divestment following a market investigation. This power is in itself rare – for example, the European Commission cannot order divestment on a sectoral investigation.

Despite the nature of a market investigation not being to find an infringement, i.e. culpability of an operator, this remedy is undoubtedly regarded by BAA as punitive. Its share of passenger traffic in both south-east

England and Scotland will be cut to 50%, and to 34% in the UK as a whole, effectively halving its capacity. Only in the case of Aberdeen airport did the CC fall short of structural remedies, opting only to impose behavioural (information provision) remedies.

The CC also made significant proposals for regulatory reform, including new statutory objectives for the regulator to promote the interests of existing and future consumers, wherever appropriate by promoting effective competition (a clear nod to regulatory practice in the telecoms sector). It also proposed a licence-based regime setting out binding commitments on airport operators, a new right of appeal by passenger groups and airlines to the CC, and provision for the separate development and ownership of airport terminals (which appears possibly to be almost an 'access' type obligation).

Observations

The CC's report is firstly an unflattering verdict on the Government's 1987 privatisation of the old British Airports Authority, and the resulting regulatory structure (not to mention the 'monopoly rent' taken by the Government on that privatisation). Given the Government's stated objective at the time to provide capacity to meet anticipated demand, the failure of the regime subsequently to deliver such capacity is stark.

Secondly, the divestment remedy is unprecedented for a market investigation by the CC, and draconian given the lack of any breach of law or regulatory obligation by BAA. In fact, it exceeds the sanction which BAA could expect to have suffered for a breach of Chapter I or II of the Competition Act 1998 (equivalent to Article 81 and 82 EC). The CC does make an interesting comparison with a merger situation, suggesting that a merger which created market shares equivalent to those held by BAA would be prohibited. Divestment is an obvious remedy in merger situations, but the need to price divestment risks into merger valuations is well recognised. That is currently not true of situations where an existing business is simply operating as normal and observing all of its legal or regulatory obligations – few businesses would expect such a risk, and in particular it seems that Ferrovial did not price that risk into its purchase of BAA (although the initial stages of the market investigation were already under way when Ferrovial made its bid).

On that note, the cost to BAA and Ferrovial will be high, and the forced divestments will almost certainly destroy value. Quite aside from the normal loss of operating synergies, in the current climate some reports predict that BAA may even recoup only 50% of the airports' value. BAA will have to divest three major airports within two years, in sequence. While an eight month divestment period might ordinarily have appeared reasonable, in the current climate it may put BAA under real pressure (albeit the CC has stated the timetable to be 'flexible').

The effects become more concerning when removed from the particular context of BAA. The significance may be for operators (and their shareholders) in other sectors characterised by one or a few large operators. A precedent is created which may fundamentally affect their value, whether the privatisation value of a State-owned business or the normal market value of a company in the private sector. This seems to be the case even where any market failure results from the manner in which those markets have been set up, even by Government itself, rather than from the behaviour of an operator.

High Court decision in *Cityhook* maintains wide discretion for regulators over how to prioritise their caseload

After a four year investigation into claims of Competition Act infringements brought by Cityhook Limited ("Cityhook"), the case was dropped by the Office of Fair Trading ("OFT"), citing other priorities. The Court held that the OFT had discretion to make that decision based on resources, that the stated selection criteria were lawful, and that whilst the OFT's assessment of the case against the criteria was flawed in part, this did not affect the final decision, which was upheld. However, the OFT was ordered to remit the case to communications regulator Ofcom, which has concurrent jurisdiction in competition matters in the communications sector.

Factual background and history of court proceedings

Cityhook was formed in 1999. It had developed a novel method of landing sub-sea telecommunications cables on beaches by creating one large tunnel extending from the beach in which users could lease space for their cables. Companies wishing to lay new cables did not have to prepare their own beach landing site, and could avoid the resulting expense and environmental upset. Cityhook believed that this technology was potentially of great benefit to new entrants to the international telecommunications market. Cityhook entered into a contract with the Duchy of Cornwall requiring all new cables landed at Duchy-controlled beaches to utilise the Cityhook technology.

Cityhook alleged that a telecommunications trade body, the UK Cable Protection Committee, and certain of its members had then arranged a collective boycott of the technology, by requesting members only to land new cables on beaches not controlled by the Duchy.

In February 2002 Cityhook complained to the OFT about the alleged boycott, and in August of that year the OFT opened a formal investigation. At various times over the next four years the OFT indicated to Cityhook that a statement of objections ("SO") had been drafted, but no decision had been made to issue it. Various deadlines were given and missed until in January 2006 the OFT issued a provisional closure letter, indicating that subject to a consultation on the matter, no SO would be issued and the case would be closed. This decision was confirmed in June 2006.

In August 2006 Cityhook challenged the decision to close the case in the Competition Appeal Tribunal ("CAT"). In April 2007 the CAT held that it had no jurisdiction to hear the appeal. The decision to close the case did not amount to a decision whether there had been an infringement of the Chapter I prohibition. Instead, it was a determination not to reach an infringement or non-infringement decision that was lawfully based on the administrative priorities of the OFT. As a result Cityhook sought judicial review of the decision to close the case in the High Court.

Issues for the High Court

There were three main issues before the Court:

1. Does the Competition Act 1998 allow the OFT to decide to close a case on the basis of resources?

Cityhook argued that once the OFT had decided to open an investigation, the issue of resources then became void. Any decision to close a case (or "not to make a decision") should be based on "intrinsic features of the case", and not on administrative priorities or resources, which would have been considered when deciding to open the investigation.

The Court held that the OFT's discretion under section 25 of the Competition Act 1998 was not limited in this way, and that there were no grounds for excluding administrative priorities. However, the specific decision would still be prone to judicial review on the traditional grounds of unreasonableness or irrationality.

2. Whether the OFT's prioritisation criteria had no statutory base

During 2005 the OFT had announced new prioritisation criteria in order to assist it in deciding which cases should be taken further and which should not be investigated. These were: consumer benefit; strength of evidence; the type and nature of the infringement; special, aggravating or mitigating factors; precedent and policy considerations; and whether the OFT is the most appropriate body, or competition enforcement the most appropriate instrument. Cityhook argued that consumer benefit and the nature of the infringement had no statutory basis and should not have been taken into account when deciding to close the case. The Court held that, as one of a number of factors, each criterion was appropriate, though any one used exclusively was probably not sustainable.

3. Whether the OFT's assessment of the case against the prioritisation criteria was flawed

Cityhook claimed that the OFT's provisional closure letter did not set out sufficient information to allow them to comment fully when responding, and that in other areas the reasoning of the OFT was wrong. Here the Court held that the closure letter was not as open and fair as it could have been, but that this had ultimately made no difference. If representations had been made to the OFT the case would still have been closed, as the real issue was lack of resources. It made no difference that the OFT had been unable to resolve its internal discussion on whether the alleged infringement was "hardcore" or not.

The OFT had also listed other reasons why the case should be closed, and here the Court did find that the reasoning was flawed in parts, and did not properly respond to the arguments raised by Cityhook's response to the provisional closure letter. However, these flaws were still not sufficient to set aside the decision since, as before, the real reason for the decision to close the case concerned resources. This was a perfectly valid reason, and since it did not satisfy the *Wednesbury* test of irrationality there were no grounds to set the decision aside.

Should the OFT have given Ofcom the opportunity to continue the case?

A further argument was raised by Cityhook that, as Ofcom had concurrent jurisdiction as a result of the telecommunications aspects of the case, once the OFT had decided to close the case it should have been offered to Ofcom as an alternative enforcement body. The Court agreed that Ofcom should have been given the opportunity to decide whether to hear the case. As such the Court ordered the OFT and Ofcom to give proper consideration to the transfer of the case.

Impact of the judgment

The decision of the High Court is unhelpful to the complainants in that a decision is not assured even once an investigation has been initiated, and the High Court has broadly upheld the wide discretion of the OFT and others to decide to terminate a case on resource grounds. Whilst Cityhook can now seek to persuade Ofcom to take on the case, it is difficult to believe that that regulator – itself resource-constrained – will be enthusiastic to revive an almost decade-long investigation that the OFT found too challenging to conclude.

Recent case law developments in public procurement

There have been a number of public procurement cases in the High Court in Northern Ireland in recent months. Three of the most recent and interesting cases are discussed below, along with a recent English case concerning the role of judicial review in public procurement law.

***Federal Security Services Limited v The Northern Ireland Court Service* [2009] NIQB 15**

This case concerned ambiguous requirements set by the contracting authority and the proportionality of the steps which it took to rectify this ambiguity. The case shows that seeking to rectify an error can itself result in a challenge, although in this case rectifying the error was held to be the correct approach.

The Northern Ireland Court Service commenced a competition for the award of a contract for the provision of security services under the Public Contracts Regulations 2006 (the "Regulations"). The competition was aborted and a new contract award process begun. This was based on legal advice that the instructions and statement of requirements issued to bidders were insufficiently precise regarding the requirement to hold a licence to provide security services, an issue which was vital to the process. Maybin Limited, who had been chosen to be awarded the contract under the original competition, had attached to its tender a licence which had expired. The discovery of this had led to the procedure being aborted. Federal Security Services ("Federal"), a rival bidder, brought an action contending that there was no ambiguity, and that the decision to abort the process was disproportionate in part because it could have been awarded the contract as the second placed bidder.

The Court applied a two stage test. Firstly, it applied *SIAC Construction v Mayo County Council* Case C 19/00 [2002] All ER (EC) 272 which held that the award criteria must be "*formulated in the contract documents ... in such a way as to allow all reasonably well informed and normally diligent tenderers to interpret them in the same way*". The contract award documents issued here to bidders failed to provide unambiguous criteria. In particular, the requirement to hold a licence to provide security services was included as a mandatory item, but bidders were also told that the evaluation criteria, including mandatory requirements, would be scored and weighted. As a result, it was not clear whether the holding of a current licence was a prerequisite for the award of the contract.

Secondly, the Court considered whether, if the bidders had known in advance the correct criteria, this could have influenced the terms in which they formulated their tenders (*ATI EAC* [2005] ECR 1 – 10109 (the "*ATI case*") and *R v Legal Services Commission* [2008] 2 WLR). It found that there was sufficient ambiguity in the Court Service's instructions to give rise to this possibility. However, the Court held that initiating a new competition would meet the requirements of transparency and equal treatment. It noted that Federal's initial score had been significantly lower than Maybin's. For these reasons the Court Service had acted proportionately in aborting the competition and commencing a new award procedure.

***Henry Bros (Magherafelt) Ltd and others v Department of Education for Northern Ireland (No.2)* [2008] NIQB 105 and *McLaughlin and Harvey Ltd v Department of Finance and Personnel (No.2)* [2008] NIQB 91**

These cases both related to framework agreements, (i.e. those setting out some or all of the terms on which the parties to the agreement will enter into contracts in the future). They have raised interesting points relating to award criteria (the upfront and full disclosure of which has been the subject of a number of important UK and EC cases over the past year); the grounds for interim relief; and remedies.

In *Henry Bros*, the Court ruled that the reliance on "fee percentages" in the framework agreement in this case did not allow the contracting authority to judge the most economically advantageous or lowest price bid. A discussion of rates and costs would still need to take place after an individual contract under the framework agreement was granted.

In *McLaughlin*, the contracting authority had used a methodology (in particular regarding weightings) that would have affected the presentation of tenders but had not been disclosed to bidders prior to the submission of their tenders and therefore breached the requirement of transparency (as per the *ATI* case).

In both cases the applications for interim relief were unsuccessful under the heading of balance of convenience between the parties, showing that it can be difficult to obtain interim relief. In *Henry Bros*, for example, the granting of an injunction would substantially increase the cost of public projects, and cause delay which could result in loss of central government funding.

Regarding remedies, Regulation 47(9) of the Regulations provides that, once a contract has been entered into, the Court cannot set it aside. However, in these cases the Court held that the framework agreements were not "contracts" for these purposes and could therefore be set aside. In *Henry Bros*, the Court reasoned that, as the framework agreement in question did not establish all the terms to bind the parties, it could not be considered a contract for these purposes (as distinct from individual contracts that were subsequently entered into pursuant to the framework agreement).

***Gillian Chandler v The London Borough of Camden* [2009] EWHC 219 (Admin)**

A parent of school aged children in Camden applied for judicial review of the local authority's decision to support the establishment of an academy sponsored by University College London ("UCL") in her area, and the Secretary of State's decision to approve UCL's formal "expression of interest" to sponsor the academy.

The Court ruled, in line with a number of previous cases, that a claim relating to breach of the public procurement rules cannot be brought by way of a judicial review application. Public procurement rules engage rights of a private character which are only actionable by a person who has such rights within the applicable procurement legislation. The parent did not have sufficient interest in the proper observance of the procurement rules to bring a challenge under them, and was not an "economic operator" (to whom a duty is owed) for the purposes of the legislation.

The Court also considered whether the procurement rules would have applied if the parent had been entitled to bring a challenge. It held that the sponsor of an academy is not involved in an economic activity (the case did not involve the selection of a contractor to build the school, for example) and state schools do not compete economically. As such, the procurement rules do not apply to sponsoring an academy. The Court indicated that it would be reluctant to find the public procurement regime applies where philanthropic actions are concerned, because the regime is underpinned by the concept of a "market" in the services being procured.

Cartel round-up

Throughout the latter months of 2008 and into 2009, the European Commission has continued its crusade to tackle cartel behaviour in the EU by carrying out dawn raids on suspected infringers and imposing record fines on cartel participants. Some major decisions are summarised below.

Marine hose

In May 2007 the European Commission carried out dawn raids at the premises of a number of producers of marine hoses. Marine hoses are used to transport oil to and from ships for transportation from production sites. The Commission found that between 1986 and 2007 six producers of marine hoses had operated a worldwide cartel to fix prices, allocate bids and markets, and exchange sensitive information.

For the first time, the Commission used its power (which it has held since 2004) to carry out an inspection at a private home, in addition to commercial premises, where it has a reasonable suspicion that books or other records related to the business and to the subject matter of the inspection are being kept at those premises.

In January 2009 the Commission imposed fines totalling €131.5 million, with the largest individual fine amounting to €25.6 million. The Japanese company, Yokohama, would have been fined €14.4 million but benefited from full immunity under the terms of the Commission's 2006 Leniency Notice as it was the first company to provide information on the cartel to the Commission.

The Commission's investigation was carried out in coordination with a parallel procedure by the US Department of Justice. The UK competition authorities brought criminal charges under the Enterprise Act 2002 against three individuals who were implicated in the cartel. All three were imprisoned in the UK and were disqualified as company directors for between five and seven years. The Japanese authorities have also taken action against the companies involved.

Car glass

In February 2005 the Commission carried out dawn raids in the car glass sector in Belgium, France, Germany, the UK, Sweden and Italy. Car glass is a type of safety glass which does not shatter on impact. The Commission found that between 1998 and 2003 four producers of car glass held regular meetings in order to allocate markets between themselves, discuss target prices, and exchange commercially sensitive information.

In November 2008, the Commission imposed fines totalling €1.38 billion – the largest ever imposed by the Commission on cartel participants (the next highest being the €92.3 million imposed in the lifts and escalators cartel in February 2007). The individual fine of €396 million imposed on Saint-Gobain was also the largest fine ever imposed on a single company. In accordance with the Commission's 2006 guidelines on fining, Saint-Gobain's fine was increased by 60% as it was a repeat offender (having been fined in 2007 for its participation in the previous flat glass cartel). In the past, the Commission has increased a fine by 90% for recidivism.

Banana importers

The Commission decided in October 2008 to impose fines on two banana importers, having carried out dawn raids at the premises of several companies in 2005. It found that the cartel members had

coordinated quotation prices for bananas and, in particular, that between 2000 and 2002 the companies set and announced their reference prices on a weekly basis.

The total fine imposed was €60.3 million. One cartel member, Chiquita, benefited from full immunity under the Commission's Leniency Notice, escaping a fine of €83.2 million, as it blew the whistle on the cartel to the Commission.

Paraffin wax

Also in October 2008, the Commission announced that it had fined nine corporate groups a total of €676 million for participating, between 1992 and 2005, in a price-fixing and market-sharing cartel relating to paraffin wax. Paraffin wax is used in a wide range of consumer and industrial products.

The largest individual fine amounted to €318.2 million, while Shell received complete immunity from a fine of €96 million under the terms of the Commission's Leniency Notice in return for blowing the whistle. ENI's fine of €29.1 million included an increase of 60% as a result of its previous involvement in the PVC and polypropylene cartels. Sasol's fine of €318.2 million was increased by 50% as it was the leading member of the cartel. Repsol and Exxon Mobil both received reductions in return for cooperation with the Commission's investigation.

Overview

In total, the Commission issued seven cartel decisions in 2008 with fines amounting to around €2.2 billion. The Commission has stated that, through these high fines, it aims to encourage: (i) the management of companies to monitor their staff very carefully; and (ii) shareholders to keep a close eye on the managers of their businesses. The Commission's willingness to increase fines for recidivism or for assuming a lead role in a cartel, contrasted with its ability to grant leniency to whistleblowers, sends out a strong signal that companies involved in cartels should approach the Commission as quickly as possible in order to avoid these huge fines.

In 2009 the Commission has already staged dawn raids in the refrigeration compressor, power cable and smart-card chip industries, and has issued a statement of objections to operators in the pre-stressing steel market. This sends out a signal that, while it may be channelling a significant proportion of its resources into tackling the current financial crisis, the Commission has no intention of letting up in its pursuit of cartelists. In a recent speech to the International Bar Association, Commissioner Kroes stressed that in spite of the credit crisis it was "*business as usual*" for the Commission, and that "*anyone who thinks we are distracted or going soft will find out the truth the hard way.*" Further, the imprisonment of three individuals implicated in the marine hose cartel shows that, in the UK at least, criminal prosecution for cartel behaviour is now a very real possibility.

Key contacts



London



Howard Cartlidge
Partner & Head of EU/Competition
+44 (0)20 7067 3146
howard.cartlidge@olswang.com



Alasdair Balfour
Partner
+44 (0)20 7067 3134
alasdair.balfour@olswang.com



Colin Long
Partner
+44 (0)20 7067 3179
colin.long@olswang.com



Rob Bratby
Partner
+44 (0)20 7067 3566
rob.bratby@olswang.com



John Enser
Partner
+44 (0)20 7067 3183
john.enser@olswang.com



Purvi Parekh
Partner
+44 (0)20 7067 3524
purvi.parekh@olswang.com

Brussels



Dirk Van Liedekerke
Partner
+32 (0)2 641 1271
dirk.van.liedekerke@olswang.com



Koen Platteau
Partner
+32 (0)2 643 4930
koen.platteau@olswang.com

Berlin



Dieter Neumann
Partner
+49 (0)30 700 171-114
dieter.neumann@olswang.com



Christoph Enaux
Associate
+49 (0)30 700 171 140
christoph.enaux@olswang.com

About Olswang



Olswang is a leading business law firm with a distinctive approach. Our pioneering and problem-solving ethos has established a commanding reputation in a wide range of industries.

Founded in 1981, our Firm has grown to a team of over 650, including over 100 partners, across four European offices. In addition, Olswang has a formal alliance with a major US firm Greenberg Traurig LLP and a long-established best friends network of leading independent law firms throughout the world. For the last four years Olswang has been ranked in The Sunday Times 100 Best Companies to Work For and our strong management team is dedicated to the personal and professional development of our people.

Our Firm continues to be acknowledged as a leading practice in many of our core areas: Olswang was short-listed for EU/Competition Team of the Year at the annual Legal Business Awards and was voted TMT Team of the Year 2009 for the second year running; Olswang's Corporate Group won M&A Law Firm of the Year at the M&A Awards 2008 in conjunction with M&A Magazine, and was named Corporate Team of the Year – Mid markets at The Lawyer Awards 2008.

From world-class businesses to entrepreneurial startups, the rich diversity of our client base ensures a broader perspective and, as a result, deeper commercial insight. We work closely with our clients to develop a deep understanding of their business and a long-term relationship. We employ a range of proactive initiatives such as client care programmes, secondments, client training and feedback sessions to ensure our client relationships are strong.

At Olswang the passion of our lawyers, the confidence of our approach and the commercial edge to our advice provide a unique and compelling service.

The information contained in this update is intended as a general review of the subjects featured and detailed specialist advice should always be taken before taking or refraining from taking any action.

© 2009 Olswang

OLSWANG

London
90 High Holborn
London WC1V 6XX
T +44 (0) 20 7067 3000
F +44 (0) 20 7067 3999

Thames Valley
Apex Plaza, Forbury Road
Reading RG1 1AX
T +44 (0) 20 7067 3000
F +44 (0) 20 7071 7499

Berlin
Potsdamer Platz 1
D-10785 Berlin
T +49 (0) 30 700171-100
F +49 (0) 30 700171-900

Brussels
Avenue Louise 326 bte 26
Louizalaan 326 bus 26
B-1050 Bruxelles/Brussel
T +32 2 647 4772
F +32 2 644 2165