

ANTITRUST & COMPETITION UPDATE

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New Hart-Scott-Rodino Reporting Requirements For Foreign Transactions

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The Federal Trade Commission ("FTC") has made important changes, effective April 17, 2002, to the Hart-Scott-Rodino Act ("HSR Act") rules for the reporting of mergers and acquisitions involving companies or assets located outside the United States. These changes restructure the tests used to determine whether mergers and acquisitions involving foreign companies or assets are subject to pre-merger notification requirements, and they also update threshold levels to conform to recent HSR Act amendments.

The good news for companies is that the changes may eliminate the need to report some transactions. On the other hand, the new rules also narrow the exemptions in some respects, for example, by eliminating the prior blanket exemption for all acquisitions of foreign assets by foreign persons.

Background

The HSR Act requires that parties to certain mergers and acquisitions report the proposed transaction to U.S. antitrust authorities. The law imposes a waiting period that prohibits the parties from closing the deal until the FTC and the U.S. Department of Justice have had an opportunity to review and decide whether to try to block or condition it. Statutory amendments to the general HSR reporting requirements, effective in 2001, established new filing thresholds.

- If the transaction involves the acquisition of at least \$50 million of assets or voting securities from the other party (subject to certain attribution and aggregation rules), and if a size-of-purchaser test is met (for example, if the seller has at least \$10 million in total assets and the buyer has at least \$100 million in net sales or total assets), the transaction must be reported.
- If the transaction involves the acquisition of \$200 million or more of stock or assets, it must be reported regardless of the size of either party.

The recent HSR Act amendments also adopted graduated filing fees:

- \$45,000 if the acquiror will hold less than \$100 million of stock or assets of the seller;
- \$125,000 if the acquiror will hold at least \$100 million but less than \$500 million; and
- \$280,000 if the acquiror will hold \$500 million or more.

The New Regulations

The new regulations modify the exemptions from HSR Act reporting obligations for transactions involving foreign companies or assets. Those exemptions are now organized by the type of the transaction rather than, as before, by the location of the acquiring party. The new rules deal separately with (1) acquisitions of assets located outside the U.S. and (2) acquisitions of voting securities of a foreign issuer. (The FTC also changed the rules for acquisitions involving agricultural assets and for transactions that are partially subject to review and approval of another regulatory agency.)

New Section 802.50 generally exempts acquisitions of assets located outside the U.S. if those assets generated less than \$50 million of sales in or into the United States during the previous fiscal year. When a U.S. entity acquires both U.S. assets and foreign assets that generated sales in or into the United States, the exemption can be applied to the foreign assets separately from the U.S. assets, based solely on U.S. sales attributable to those foreign assets. Previously, the exemption required the aggregation of U.S. sales attributed to both the U.S. and foreign assets.

New Section 802.51 governs acquisitions of voting securities of foreign issuers. Such acquisitions are exempt unless the foreign issuer (including all entities that it controls) holds U.S. assets with an aggregate total value of more than \$50 million (with some exceptions), or had aggregate sales in or into the United States of more than \$50 million during the previous fiscal year. That exemption applies whether the acquirer is from the U.S. or from a foreign country. In addition, acquisitions by a foreign person of voting securities of a foreign issuer are exempt if the acquisition does not confer control of the issuer.

The new rule also exempts both asset and voting securities transactions when both the acquiring person and the acquired persons are foreign, provided that two conditions are met: (1) the acquiring person will not hold assets and voting securities of the acquired person valued at more than \$200 million; and (2) the acquiring and acquired persons (a) did not make aggregate sales in or into the United States in their most recent fiscal years of \$110 million or more and (b) do not hold aggregate total assets (with some exceptions) located in the United States with a value of \$110 million or more.

Although the revised exemption rules rely on financial measures with specified dollar amounts, determining these values in a given transaction can require particular care. When determining the value of assets under the new rules, the test is now "fair market value" rather than the value specified in the acquired person's most recent balance sheet. Special rules outside the exemptions continue to govern how to calculate both "fair market value" of assets and the value of voting securities. Companies must be careful when determining sales in or into the United States, particularly because companies' standard financial statements may not report geographic information about sales in the same form as required by the HSR rules.

In summary, the exemptions raise the basic safe-harbor ceiling to \$50 million from the former \$15 million or \$25 million (depending on the circumstances). However, they narrow the former exemptions in two respects. First, whereas the former rules exempted acquisitions between foreign persons having aggregate U.S. sales and assets of less than \$110 million, the new rules eliminate that exemption when the total acquisition value exceeds \$200 million and the value of U.S. assets and sales involved exceeds \$50 million. Second, the rules no longer exempt all acquisitions of foreign assets by foreign persons regardless of the volume of sales in or into the U.S. attributed to such assets. Such transactions are now subject to reporting unless they qualify for one of the exemptions outlined above.

Conclusion

The number of HSR filings fell sharply in 2001 as a result of earlier changes in the statute and regulations and reduced merger activity due to general economic and market conditions. It is too early to tell whether the latest changes will further reduce the total number of transactions that companies have to report. But even if a foreign transaction is below the general reporting thresholds or falls within one of the exemptions outlined above, substantive U.S. antitrust laws may continue to apply. Although the FTC will continue to use reasonably clear financial tests to determine whether the pre-merger notification requirements apply to mergers and acquisitions involving foreign businesses, the extent to which the U.S. antitrust laws otherwise apply to activity outside the United States remains a vexing one. If a transaction has sufficient connection with the United States and raises competition concerns, the U.S. antitrust agencies may investigate it, as they recently have done in domestic mergers that were too small to be reported under the HSR Act.

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New EU Competition Law Procedures

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In September 2000, the European Commission ("Commission") adopted a proposal for a new Regulation implementing Articles 81 and 82 of the EC Treaty, which set out the European Union's competition rules applicable to restrictive practices between businesses and abuses of dominance committed by them. The new rules, currently before the Council, are expected to be adopted this year and to come into force in January 2004.

The Existing System

Article 81(1) EC prohibits agreements or practices that have an appreciably restrictive effect on competition and trade within the EEA. Agreements caught by Article 81(1) EC are automatically void by virtue of Article 81(2) EC, unless the Commission exempts them under Article 81(3) EC. Article 82 EC prohibits the abuse of (single and collective) dominant market positions that may appreciably affect trade within the European Economic Area.

Under the current system (Regulation No 17 of 1962), the Commission, national competition authorities ("NCAs") and national courts can apply Articles 81(1) and 82 EC, but only the Commission has the power to grant an exemption under Article 81(3) EC where, broadly, the economic advantages of anti-competitive agreements outweigh their economic disadvantages. The Commission's proposal aims at replacing this highly centralized authorization system, which is based on prior notification and exemption, with a "directly applicable exception system."

The Proposed System

The main characteristics of the proposed system are as follows:

- **Network of enforcers:** the Commission, NCAs and courts will have concurrent powers to apply EU competition rules, including the prohibitions under Articles 81(1) and 82 EC, and the conditions of Article 81(3) EC. Agreements falling under Article 81(1) EC will be legal or void, depending on whether they satisfy the conditions of Article 81(3) EC. The Commission intends to adopt a notice setting out guidelines on the allocation of cases between the concurrent decision-makers. In any event, the Commission retains the right to withdraw a case from NCAs. Importantly, whereas the original Commission's proposal provides that restrictive practices that may affect trade within the EEA shall be dealt with exclusively under EU competition law, the text currently before the Council provides that NCAs may apply in parallel two sets of rules: EU competition law (which must be applied to such cases) and national competition law, subject to a convergence rule (i.e., avoiding conflicting decisions).
- **Abolition of the notification and authorization system:** no prior notification and authorization decision from the Commission will be required for enforcing agreements complying with Article 81 EC as a whole. However, the Commission has the power to introduce a registration requirement for agreements falling under Article 81(1) EC, which are not covered by a block exemption. This will allow the Commission to focus on complaints and own-initiative proceedings relating to the most serious infringements (e.g., cartels, market foreclosure and abuses of dominance).
- **Commission's increased power of investigation:** the proposal provides for: (i) codification of national rules governing the obtaining of judicial orders to allow inspection of undertakings' premises; (ii) strengthening of Commission officials' power of inspection to cover private premises, seal offices, and ask oral questions; and (iii) increased fines for breaches of procedural rules (1% of total annual turnover) and periodic penalty payments (5% of average daily turnover), and a possibility to recover fines from members of an association. The Commission will also be empowered to impose all remedies necessary to bring an infringement to an end (e.g., structural remedies, commitments, and interim measures), and to adopt decisions finding infringement also when it has already come to an end. Some of these provisions are currently under discussion in the Council.

Practical Issues

- **Inconsistent application of EU competition law:** the main criticism against the proposal is that it will reduce the level of consistency of application of EU competition law, which will be re-nationalized, leading to forum-shopping. Consistency (as well as reduced red tape and a more level playing field for companies engaged in cross-border activities) was to a certain extent ensured under the original proposal, which provided for the exclusive application of EU competition law to restrictive practices capable of affecting trade between Member States. However, the current draft provides that national law may still be applied in parallel. Moreover, decisions adopted by NCAs will only bind the authority adopting the decision and will have no effects outside the national territory. Consistency may be achieved through EU block exemption regulations, guidelines, case-law, preliminary reference procedure, and mechanisms for co-operation, consultation and exchange of information. However, the Commission's increased power to adopt block exemptions is still under debate.
- **Reduced level of legal certainty:** the proposal removes the possibility for companies to get prior clearance from the Commission. By doing so, it puts the onus on companies to make their own assessment of the compatibility of their restrictive agreements or practices with EU competition law, and increases their need for legal advice. Importantly, the proposal does not extend legal professional privilege to in-house counsels, arguably much needed in a system that demands more self-assessment. Companies will get some guidance from EU block exemption regulations, guidelines, case-law (the Commission will continue to adopt prohibition decisions, and positive decisions, on its own initiative and in the Community public interest), and informal discussions with the Commission.

Other Related Developments

The pending reform of the procedural rules for implementing Articles 81 and 82 EC should be considered in the context of the following recent EU competition developments:

- **Vertical Restraints:** in December 1999, the Commission adopted a Regulation that block exempts vertical agreements, which do not include hardcore restraints (e.g., resale price maintenance, territorial restrictions), up to 30% market share. In May 2000, it adopted Guidelines on Vertical Restraints, which set out the Commission's relevant policy. The new rules entered into force in June 2000.
- **Horizontal Co-operation:** in November 2000, the Commission adopted two Regulations that block exempt specialization and R&D agreements between competitors that do not include hardcore restraints (e.g., price-fixing, limitation of output or sales, market allocation), up to 20% and 25% market share, respectively. The Commission also adopted Guidelines that set out its relevant policy. The new rules entered into force in January 2001.
- **Agreements of Minor Importance:** in December 2001, the Commission published a new Notice on agreements of minor importance, raising the thresholds for agreements which do not appreciably restrict competition and, therefore, fall outside the scope of Article 81 EC (provided they do not include hardcore restraints). The new thresholds are raised to 10% market share for agreements between competitors (horizontal agreements) and 15% for agreements between non-competitors (vertical agreements).
- **Leniency Notice:** in February 2002, the Commission's new Leniency Notice entered into force, providing greater incentives for companies to "blow the whistle" on hardcore cartels. The Notice provides immunity from fines to the first company submitting "sufficient" evidence on a cartel, enabling the Commission to open an investigation or find an infringement of Article 81 EC, provided that the company co-operates fully and continuously with the Commission, puts an immediate end to the infringement and has not coerced other companies to participate in the cartel. Reduction of fines up to 50%, 30% or 20% (depending on the timing and quality of evidence, and the extent of co-operation) will be granted to companies providing evidence which represents "significant added value," provided they immediately terminate their involvement in the cartel.
- **Pending review of the Technology Transfer Block Exemption Regulation:** in December 2001, the Commission published a report setting out its proposal for a new TTBE, which will block exempt certain restrictions subject to thresholds, in line with the vertical and horizontal new block exemptions (see above).
- **Pending review of the Motor Vehicle Block Exemption Regulation:** in February 2002, the Commission adopted a new draft Regulation, which is to replace the existing block exemption regulation applicable to car distribution agreements. It is due to enter into force in October 2002.

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Recent Court Ruling Permits Treble Damages For Antitrust Injuries Occurring Outside The United States

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United States courts recognize that U.S. antitrust laws do not regulate competition in other nations' economies. However, a recent decision by the United States Court of Appeals for the Second Circuit interprets the Foreign Trade Antitrust Improvements Act of 1982 ("FTAIA") to permit treble damages for private plaintiffs based on transactions and antitrust injuries occurring wholly outside the United States. If allowed to stand, that decision could result in increased private treble damage action filings in the U.S. based on predominantly foreign conduct.

The case grew out of the Christie's/Sotheby's auction fee conspiracy. Plaintiffs alleged that the defendants had agreed to fix auction fees, in violation of Section 1 of the Sherman Act, both in the United States and abroad. The litigation was brought on behalf of a class of all persons who paid such fees in auctions conducted outside the United States. (A parallel class action involving auctions conducted within the United States was settled.)

The trial court dismissed the case, concluding that under FTAIA the Sherman Act did not apply because the plaintiffs were not injured by conduct that had an effect in the United States. FTAIA provides that the Sherman Act does not apply to "conduct involving trade or commerce (other than import trade or import commerce) with foreign nations" unless that conduct (1) has "a direct, substantial, and reasonably foreseeable effect" on domestic U.S. trade or commerce, import trade or commerce, or the export trade or commerce of a person operating in the United States, and (2) "such effect gives rise to a claim" under the Sherman Act. Noting that "the statute is not elegantly drafted," the court held that for the plaintiffs' claim to go forward, the law required both that the conduct complained of have "direct substantial and reasonably foreseeable effects" in the United States and that those same effects be the basis for the injury alleged. It found there was no basis to conclude that import commerce was involved and held that "although influenced by a conspiracy with important U.S. elements," the transactions for which the plaintiffs were seeking damages "were entirely foreign and had no direct, substantial or foreseeable effects in the United States." (The trial court's decision can be found at *Kruman v. Christie's International plc*, 129 F.Supp. 2d 620 (S.D.N.Y. 2001).)

The Second Circuit reversed, holding that so long as the requisite effect on U.S. commerce can be shown, the Sherman Act applies regardless whether the conduct causing that effect is the basis for the alleged injury and damages. (*Kruman v. Christie's International plc*, No. 01-7309 (2d Cir., Mar. 13, 2002)) The Court of Appeals drew a sharp contrast between conduct and injury, stating that the "existence of a Sherman Act violation does not depend on whether anyone has actually suffered an injury." It held that the conduct at issue was whether the defendants had violated Section 1 by agreeing to fix prices, not whether they actually charged the resulting fees to buyers and sellers at particular auctions.

Finally, the Second Circuit held the requirement that "such effect" (a "direct, substantial, and reasonably foreseeable effect" on U.S. commerce) violates the Sherman Act which merely meant that the effect had to constitute a violation of the Act, not that the Sherman Act reached only that effect and its consequences: "The 'effect' on domestic commerce need not be the basis for a plaintiff's injury, it only must violate the substantive provisions of the Sherman Act."

The Second Circuit closed by reviewing "policy considerations" raised by its decision. It discounted arguments that permitting the case to go forward would "open the floodgates" for litigation involving foreign transactions, arguing that FTAIA merely confirmed existing Second Circuit law. It also stressed that the Christie's/Sotheby's case was "unique in that it alleges a scheme in which there were explicit agreements to fix prices in both foreign and domestic markets," and suggested that "there are natural limits to the types of anticompetitive conduct directed at foreign markets that will be actionable pursuant to the antitrust laws under the FTAIA." However, the court viewed as both appropriate and beneficial the additional deterrence of antitrust violations affecting U.S. commerce that will result from the prospect of treble damages for purely foreign injuries.

A year before the Second Circuit's decision, the Fifth Circuit reached the opposite result in a case involving an international conspiracy to fix prices and allocate markets for heavy-lift marine barges and construction services. That court held FTAIA precludes claims "where the situs of the injury is overseas and that injury arises from effects in a non-domestic market." It based that conclusion on the language of the statute, which it found to be consistent with both FTAIA's legislative history and prior decisions regarding the extraterritorial application of U.S. antitrust law. The Fifth Circuit read FTAIA to require that a "direct, substantial, and reasonably foreseeable effect" on U.S. commerce must itself give rise to the claim being brought by the plaintiff in a particular case and form the basis for the damages that plaintiff seeks. (*Den Norske Stats Oljeselskap AS v. HeereMac vof*, 241 F.3d 420 (5th Cir. 2001))

The plaintiff in the Fifth Circuit case sought review by the U.S. Supreme Court, which in turn requested the views of the United States Government as to whether it should hear the case. Earlier this year, the Government (with both the Antitrust Division of the Department of Justice and the Federal Trade Commission joining in the brief) suggested that the Court should not address the issue until other pending intermediate appeals are completed (among them, the auction case), but stated that in any event the Fifth Circuit was "correct in holding that the FTAIA requires that the anticompetitive effects on United States commerce must give rise to a plaintiff's claimed injuries." The Supreme Court thereafter denied the request to review the Fifth Circuit's decision.

Although the Supreme Court has elected not to consider the effect of FTAIA on claims of foreign injury at this time, it is likely that it will be required to do so within the next few years. The brief filed by the Government notes that "with increasing frequency foreign plaintiffs have sued to recover damages arising out of foreign purchases of conspiratorially price-fixed items, when the conspiracy's conduct also affects United States commerce," although the Second Circuit's decision is the only one to date that has allowed a Sherman Act case to go forward based on solely foreign injury. Given the need for a uniform rule of law throughout the United States on a question such as this, a definitive resolution by the Supreme Court will be necessary. Until it acts, the risk of being subjected to Sherman Act claims for purely foreign transactions cannot be excluded.

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