23 October 2002

Commission Merger Control Analysis Again Severely Sanctioned by the European Court in the Schneider Case

The Judgment

On 22 October 2002, the European Court of First Instance (CFI) annulled the European Commission's prohibition of the Schneider/Legrand merger. The Court based its judgment[1] on two main grounds:

- First, the factual analysis underlying the Commission's assessment of the impact of the transaction on the relevant national product markets outside of France was erroneous, insufficient and contradictory;

- Second, the Commission violated Schneider's rights of defense with respect to its objections relating to the French product markets.

Barely five months after the landmark *Airtours* judgment,[2] the CFI, for the second time, annulled a merger prohibition decision. This judgment confirms the CFI's determination to hold the Commission to a rigorous standard of proof. The Court had little patience with what it termed "the abstract and detached" approach of the Commission to the assessment of the facts. Indeed, like in *Airtours*, the Court's judgment uses strong and severe language in condemning the Commission's findings as vague, unclear, laconic, too general, without basis in fact, contradictory and erroneous, leading the Court to conclude: "*that the errors, omissions and contradictions* […] *in the Commission's analysis of the effects of the notified transaction are undoubtedly of a serious character.*"[3]

On the other hand, the Court rejected an important procedural argument by Schneider: that the Commission had illegally "stopped the clock" during the administrative procedure by issuing a vexatious formal information request that took nearly two months to answer.

The judgment could be read as sending a clear signal to the Commission to re-examine the merger (provided that Schneider uses its option to hold on to Legrand) with regard to its effects on the French market only, and to do so by re-issuing a new statement of objections as a next step.[4] Another interpretation could nevertheless be that the Court had in mind only to remind the Commission that even for the French markets, where the economic analysis was sufficient, Schneider must be in a position to exercise its rights of defense, prior to any new Commission decision: "*The relevant grounds of the present judgment notably imply that assuming that the analysis of the transaction would be taken up again, Schneider should be put in a position, for the affected national product markets for which the economic analysis contained in the Decision was not set aside by the present judgment, i.e., the French product markets, to effectively*

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1 A second decision, ordering the separation of Schneider and Legrand's businesses, was also annulled on the same day, the legal basis for this later decision being the annulled prohibition decision.

2 *See* WCP Bulletin "European Court Annuls Airtours/First Choice Merger Prohibition", 7 June 2002.

3 Judgment, para. 404 (unofficial translation by WCP, the judgment is currently available only in French).

4 This judgment therefore annuls the prohibition decision. The Court of First Instance adds that *"if the issue of the compatibility were to be re-examined* […], *the procedure must recommence with the drawing up of a precise statement of objections and relate only to French markets, which are the only markets to have been identified as being affected by the implementation of the merger*", Press Release No 84/02, 22 October 2002.

present its defense and, if necessary, to offer remedies addressing the objections retained and detailed beforehand by the Commission."[5] Whatever the correct interpretation, the Court's indication is somewhat unusual, as it is normally for the institution whose legal act has been challenged to draw the consequences from a judgment.

Consequences of the Judgment

The judgment will have a significant impact on future merger control cases:

- **An important step towards effective judicial review in merger cases.** Three aspects of this case illustrate that the CFI can in fact provide effective judicial review in at least some merger cases. First, the CFI's strict review of the Commission's factual findings confirms the impression given by *Airtours* that the Court is both willing and capable to engage in a near *de novo* review of mergers. Second, the Court appears to have sent a clear signal to the Commission not to look at certain markets a second time around, bringing the companies involved much closer to a final approval. Third, the CFI was able to reach its judgment in only 10 months rather than the almost three years it took to decide *Airtours,* which makes it a realistic possibility that at least some merger projects could survive an initial prohibition decision.

- **Pressure on the Commission to reform procedures**. While the Commission's first reaction has to been to say that it is studying whether to appeal, it is clear that this defeat – the first in a merger case for which Commissioner Monti was directly responsible – will add to the already existing pressure on the Commission to more radically reform its internal procedures, in particular by introducing more institutional checks and balances.

- **Possibility of additional procedural burdens on parties in contentious merger cases.** The increase in judicial scrutiny of the Commission's fact-finding, coupled with the Court's approval of the Commission's use of formal information requests to gain more time for its investigation, could mean that companies will face more of such burdensome requests. The Commission's procedure could thus come to more closely resemble the US second request procedure.

- **Uncertainty as to the procedural steps following a merger.** By suggesting that Schneider must be given an opportunity to present new arguments and undertakings in respect of the French market, the Court has cast some uncertainty on the next steps to be taken by the Commission. The Merger Regulation itself suggests that the Commission's procedure would re-start in the first phase, whereas the Court could be understood as saying that it may be sufficient to repeat the final steps of the previous second-phase procedure, as indicated by the press release. On the other hand, the wording used by the Court ("notably" or *"notamment"*) could also suggest that the Commission must at the very least respect Schneider's rights of defense, but does not necessarily prevent the Commission from taking other steps. The Commission's handling of the case after the judgment will hopefully shed light on the practical implications of annulments.

The Commission's decision and the main arguments raised by the Parties

Schneider Electric SA (Schneider) and Legrand SA (Legrand) are both French companies active EEA-wide in the low-voltage electrical equipment sector. Their core activities are located in France but Schneider is also strong in the North of Europe, while Legrand's activities are more centered in the South of Europe.

[5] Judgment, para. 465 (unofficial translation by WCP).

The Commission defined 10 different product markets, which were all found to be national in their geographic scope. In 18 of these markets (nine of which were located in France), the Commission found that the effects of the transaction would be to create or strengthen the dominant position of the Parties post merger notably due to:

- the characteristics of the market (customer loyalty, the significance of brands, the existence of barriers to entry, the price inelasticity of demand);

- the fact that the new entity would become an unavoidable trading partner (significant market shares, unrivalled size, no more competition between the parties, emergence of an unquestionable European leader, the broadest products range and the widest geographical coverage, unrivalled portfolio of brands);

- the lack of sufficient constraints from the demand side (unavoidable partner for the wholesalers); and

- the inability of competitors to significantly restrain the new entity.

The Commission further rejected all of the undertakings submitted by the parties and consequently prohibited the transaction.

Schneider appealed this decision and a later decision ordering the parties to separate their businesses.[6] In order to ensure that these appeals would be dealt with under the Court's new fast-track procedure, Schneider had to abandon some of its grounds of appeal.

The Court's main findings

The main issues dealt with by the Court were whether

- the Commission could rely on "transnational" elements and on characteristics of certain national product markets (notably France) to conclude that the new entity would be dominant in other national product markets;

- the Commission was right to exclude sales by some of the parties' competitors to their vertically-integrated downstream operations from the competitive analysis;

- the Commission properly applied the second part of the prohibition test under the Merger Regulation (which requires that the Commission show that the transaction "will significantly impede effective competition");

- the Commission violated the parties' rights of defense by failing to clearly inform Schneider of one of its objections to the merger; and

- as a procedural matter, the Commission was justified in "stopping the clock" by means of a formal information request in response to Schneider's failure to answer a very comprehensive questionnaire.

The Court's findings on these issues are addressed in turn:

Insufficient assessment of the local characteristics of the national product markets

The Court accepted in principle that in the Commission's analysis as to whether the operation leads to the creation or strengthening of a dominant position in the relevant *national* product

[6] Following Schneider's initiation of summary proceedings, the Commission agreed to delay the implementation of the separation order, on the condition that Schneider withdraw its application for summary proceedings.

markets, the Commission could take into consideration "transnational" effects, *i.e.*, effects resulting from the presence of the combined entity across Europe. On the facts, however, the CFI found that the Commission merely added the positions held by the merging parties on the various national product markets without really reviewing these positions in detail and extrapolated certain characteristics of certain national product markets (in particular the French market). The Commission failed to demonstrate the relevance of these elements for its analysis of the competitive situation in the different national product markets under investigation. Moreover, the CFI went on to analyze whether the generalizations and the specific local examples relied upon by the Commission were supported by the facts. On the basis of a very detailed and critical analysis of the contested parts of the Commission's reasoning, the CFI stated that it was not convinced by the Commission's case.

Failure to take into account integrated sales

The CFI found that the Commission had failed to recognize that for some large projects (as opposed to sales to wholesalers) the parties were in direct competition with the vertically integrated downstream operations owned by some of their competitors, notably ABB and Siemens. One could ask whether this should not have led to the conclusion that the large projects segment in fact constituted a separate market. However, the CFI had not been asked to review the product market definition in this case. It therefore concluded that the Commission was wrong in excluding from the market the sales by the vertically integrated downstream operations. As a consequence, the Court found that the Commission had underestimated the market shares of the relevant competitors.

Significant impediment of effective competition

In *Airtours*, the Court made several references to the fact that the Commission cannot prohibit a transaction without demonstrating that it creates or strengthens a dominant position "*as a result of which effective competition would be significantly impeded in the common market*". To date, the Commission has (even by its own admission) paid little attention to the second part of the prohibition test, which can be read as requiring the Commission to engage in a more dynamic rather than merely structural assessment of the market.

For the first time, in the present case, the CFI examined in detail whether the Commission had in fact convincingly shown that the second part of the test was met as far as the Danish and the Italian markets under consideration were concerned. It should be noted that the Court did not need to address that question, since it had already found that the Commission had failed to prove that the transaction would lead to the creation or strengthening of a dominant position on those markets. It would appear therefore that the CFI wanted to emphasize the need for the Commission to establish that the transaction meets both parts of the test. This will be important for the *GE/Honeywell* case, among others, in which the parties are understood to have made the second part of the test a major plank of their appeal.

Violation of the parties' rights of defense

In the administrative procedure, the Commission must issue a statement of objections detailing its preliminary findings on the compatibility of the merger with the common market, and must allow the notified parties to be heard on these objections prior to taking a negative decision.

Although the CFI granted that the statement of objections could not be expected to anticipate all the potential issues that could be raised by the parties in response, it stressed that the statement of objections should at the very least contain all of the Commission's objections in sufficiently clear wording so as to allow the notifying parties to exercise their rights of defense. The CFI emphasized that the respect of the rights of defense is not only important in that it allows companies to respond to the objections with counter-arguments, but it also enables them to craft undertakings that are tailored to meet the Commission's objections.

In the case at hand, the Court found that the Commission had not clearly stated that one of its objections as regards the French market related to a conglomerate issue: the alleged strengthening of the position of Schneider in certain product markets because of Legrand's position in other product markets. This objection was used by the Commission to reject Schneider's undertakings and was only clearly stated in the final decision. The Court therefore concluded that Schneider's rights of the defense had been violated.

This finding was crucial to Schneider's case since the deficiencies in the Commission's analysis of the competitive market situation did not apply to France. The Court indeed found that the Commission was right in concluding that the operation would lead to the creation or strengthening of a dominant position on the French markets, which the CFI considered would significantly impede effective competition. This was in fact not disputed by Schneider. In other words, if Schneider had not been successful in its claim that its rights of the defense had been violated, the CFI would have refused to annul the Commission's decision.

Stopping the clock through formal information requests

In addition to these pleas, the Court also considered whether the Commission had respected the deadlines for reaching a prohibition decision provided in the Merger Control Regulation. Here, the CFI confirmed that a formal Commission decision containing a request for information has the automatic effect of suspending the course of the four-month deadline for rendering a prohibition decision, until such time that the notifying parties have fully complied with the request. While the Court left open the possibility that such a request could be illegal, it did not make such a finding of illegality in the present case. The Court held that the Commission was entitled to issue a formal request since the 322 questions (!) were necessary for the assessment of the case and the time limit of five working days was reasonable in view of the fact that they related to issues that had been informally discussed between the parties and the Commission since the pre-notification stage.

It would thus appear that the Commission is granted rather wide discretion to ask questions to the parties in order to suspend the time limit whenever it needs more time for its investigation. The Commission may be tempted increasingly to make use of such techniques especially now that the Court has imposed on the Commission a very strict burden of proof as regards the merits of its cases. However, the Commission should be mindful of the Court's case law in the State aid field,[7] which shows that there are clear limits on the Commission's discretion to ask questions just for the sake of winning time.

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[7] Case C-99/98, *Austria v. Commission*, Judgment of the Court of Justice of 15 February 2001, in which the Court of Justice sanctioned the Commission for having sent repeated requests to Austria in order to gain time during the informal phase of the procedure and avoid having to reach a determination within the set two-month time limit.

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