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Europe's Court of First Instance Rules That Schneider Should be Partially Compensated for Commission's Illegal Blocking of its Merger with Legrand

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On 11 July, the European Court of First Instance (CFI) ruled that the European Community (EC) must compensate Schneider Electric SA (Schneider) for losses suffered as a result of the European Commission's illegal prohibition of its proposed merger with Legrand SA (Legrand).[1] This is the first case on the right to damages for an incorrect merger decision, an area in which the Commission traditionally enjoys substantial discretion.

Background

In 2001, the Commission prohibited the merger of Schneider and Legrand, two French companies active in the electrical equipment sector. Schneider had already purchased 98% of Legrand and—following the Commission's decision—it agreed, in July 2002, to sell the shares to a third party, Wendel/KKR. In parallel, Schneider appealed to the CFI and, in October 2002, the CFI annulled the Commission's prohibition decision—one of three unprecedented and high-profile annulments in 2002.[2] In its agreement with Wendel/KKR, Schneider had negotiated that the transaction would be executed in December 2002, allowing Schneider to pursue its original plan to purchase Legrand in the event of a favourable ruling from the CFI. Following the CFI's annulment, Schneider sought to complete the transaction with Legrand and the Commission reopened its merger investigation. In early December 2002, Schneider—who had continued to meet resistance from the Commission—decided to abandon the acquisition of Legrand and instead sold the shares to Wendel/KKR.

Schneider filed an action for damages before the CFI, claiming compensation for losses it allegedly suffered as a result of the Commission's illegal merger prohibition. Aside from a still-pending similar claim brought by MyTravel Group plc, such an action for damages resulting from Commission errors in the merger control context was unprecedented.

The CFI's Judgment

The CFI considered first the type of error that can give rise to liability and, second, whether different kinds of damages can be said to have been caused by the error in question.

Errors That Can Give Rise to Liability

The right to claim damages from the EC for unlawful acts by its employees or institutions is well established. The European courts have, however, been somewhat cautious in awarding damages where the EC institution enjoyed a margin of discretion, holding that, for damages to be warranted, the institution must have “manifestly and gravely” disregarded the limits on the exercise of its powers. Traditionally, the European courts have also allowed the Commission considerable latitude when making “complex evaluations on economic matters” in competition law; but, in recent years, the CFI and the European Court of Justice have strengthened the intensity of their review of Commission decisions.

Schneider claimed that the Commission had manifestly and gravely disregarded the limits on its margin of discretion in a number of ways. It relied principally on two findings made by the CFI in its October 2002 annulment judgment: first, that the Commission had made errors when analysing the economic impact of the proposed merger outside of France and, second, that it had not given Schneider the chance to defend itself against an argument based on the portfolio effects of the merger in France. Schneider also alleged that the Commission had subsequently made errors that had increased the damage suffered.

The CFI began its analysis by attempting to define the “threshold” of error for which the EC may incur liability. It emphasised that the Commission must be allowed a certain margin of discretion in merger cases. However, where the Commission makes errors that are manifestly incorrect and these cause damage to third parties—and when these cannot be “justified or explained” by what the CFI terms “the objective constraints of the merger-control procedure”—compensation should be available. The scope of the defence afforded by these constraints is bound to be an issue in future cases, but the court does provide some guidance when considering Schneider’s claims.

The CFI had no hesitation in categorising the infringement of Schneider’s right to be heard on the possible portfolio effects of the merger as being sufficiently serious to give rise to liability. As the CFI had previously found, the Commission had based its decision on an argument that was not in its Statement of Objections. As a result, Schneider was unable to address this argument when it offered divestments to remedy the Commission’s concerns over the merger, which led to the annulment of the Commission’s prohibition of the merger. The CFI, casting some light on the “objective constraints of the merger control procedure,” now reasoned that the Commission’s error was not connected to its market analysis, was not due to any particular technical difficulty and would not have required any supplementary analysis that was impossible within the prescribed timeframe.

As regards Schneider’s claim relating to the Commission’s incorrect analysis of markets outside France, however, the CFI held that these errors were not sufficiently serious—given the Commission’s concerns regarding French markets—to have changed the overall outcome of the Commission’s decision and thus given rise to liability.

The CFI does not, however, “exclude in principle” that grave and manifest errors of economic analysis could sometimes cause damage that should be compensated. As a preliminary, the plaintiff would have to show that the error infringed a rule of law intended for the protection of individuals; the CFI states that not all errors relating to economic analysis would have this character. The CFI cautions against such errors giving rise to liability, emphasising that economic assessments involve complex and difficult prospective analyses often requiring certain approximations and presumptions—some of which may, moreover, be necessary given the tight deadlines that the Commission is under in merger control cases. Recalling the Commission's margin of discretion in competition law cases, the CFI considers that the Commission must be allowed latitude over, for example, the econometric models that it chooses—provided that these choices are not clearly contrary to economic discipline and provided that they are logically followed.

The CFI's comments, although *obiter*, do display a hesitation in accepting an action for damages where the Commission has "only" committed substantive errors of assessment rather than procedural errors. While the latter are easier to identify and normally less contentious than substantive errors resulting from the exercise of discretion, the CFI does not rule out awarding damages for erroneous economic assessments. This is consistent with its increased willingness, as evidenced in cases like *Tetra Laval* and *Airtours*, to examine the economic reasoning behind Commission decisions when exercising judicial review. The CFI will have a chance to revisit this issue when it rules on the *MyTravel* (formerly Airtours plc) action.

The CFI rejected Schneider's allegations that the Commission had committed other relevant errors.

Causation and Kinds of Damage That Can Be Compensated

Schneider's main damages' claim related to the difference between the price at which it purchased the Legrand shares in 2001 and the price at which it sold them in December 2002. The CFI, however, rejected this claim, which it considered as resting on the false premise that the Commission would have adopted a decision authorising the merger in the absence of the violation of the right to be heard on the arguments relating to French markets. The CFI instead analysed the effects of this violation and concluded that the main consequence was that Schneider was unable to offer a satisfactory remedy to allay any concerns over portfolio effects. The violation did not mean that the Commission's economic analysis of the French markets was in itself incorrect.

Second, the CFI ruled that Schneider should not be compensated for the loss of the chance of having the merger cleared. Schneider had argued that if it had known of the Commission's concerns regarding the French markets, it could have offered a divestment package that would have allowed the transaction to proceed. The CFI rejected this; it was too difficult to determine the extent of the divestment that would have been required and its impact on the value of the shares held at that time by Schneider. Moreover, the CFI noted that the extent of the divestment package might have made the entire transaction unattractive to Schneider, leading to its abandonment.

Third, the CFI rejected any entitlement to be compensated for synergies that might have resulted had the merger gone ahead. Again, the CFI noted that a decision authorising the transaction was not certain even if the Commission had not committed the procedural error giving rise to liability.

On the contrary, the CFI ruled that the EC should reimburse Schneider for two types of damage that were sufficiently linked to the Commission's failure to respect Schneider's procedural rights. First, the CFI's annulment of the Commission's decision resulted in the merger investigation being reopened, and in additional costs for Schneider. The costs incurred in the reopened procedure were higher than the costs that Schneider would have incurred had the Commission respected its procedural rights in the original investigation. Second, as mentioned above, Schneider had negotiated the postponement of the execution of the sale of the Legrand shares to Wendel/KKR. The CFI considered that the reduction in the sale price attributable to this postponement should be indemnified. The court accepted, however, that Schneider had adopted a high-risk strategy in these negotiations and for this reason it should only receive two-thirds of this amount in compensation.

The final amounts that the EC will pay Schneider will be settled following the consideration of further submissions and expert reports.

Implications

This is the first case where wrongful prohibition of a merger has been the basis for EC liability. The case is unlikely to lead directly to a flood of litigation, as the Commission has not blocked many mergers and the CFI has only annulled four of these. Nonetheless, the CFI has established that the EC is liable where the Commission commits a procedural error in a competition case that causes damage. This principle could apply in other contexts, not just merger control.

Further cases, most immediately *MyTravel*, will elucidate the extent to which a party can claim damages for errors in the Commission's substantive assessment. If such a claim is successful, the EC could be liable for substantial amounts of damages, as, unlike a procedural violation, it should be easier to show that the overall outcome of the decision would have been different. Thus, a party could be able to claim profits that it would have generated had its merger not been wrongly prohibited. Again, a ruling against the Commission on this point could have implications beyond the merger control context. For example, a company that successfully appeals a decision finding that it had abused a dominant position could potentially claim damages for losses resulting from the Commission's original decision.

MyTravel has also claimed damages for loss of synergies, which was rejected in *Schneider*. To overcome the court's reluctance to compensate for synergies, MyTravel will have to demonstrate that clearance would have been very likely in the *Airtours* case had the Commission not made errors when assessing collective dominance. In this context, it is noteworthy that the Commission recently authorised two mergers (*KarstadtQuelle/MyTravel* and *TUI/First Choice*) in the relevant product market.

In sum, the CFI breaks new ground in *Schneider*, but further cases will be required to ascertain the full extent of the EC's liability in antitrust cases. The CFI would seem to have set the bar quite high, certainly when it comes to claims for substantive errors of assessment.

The parties can appeal the judgment on points of law to the European Court of Justice within two months.

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[1] Case T-351/03, *Schneider Electric SA v Commission*, CFI Judgment of 11 July 2007, currently only available in French at http://curia.europa.eu/en/transitpage.htm.

[2] For a review of this judgment see our bulletin of 23 October 2002, “Commission Merger Control Analysis Again Severely Sanctioned by the European Court in the *Schneider* Case”, available at http://www.wilmerhale.com/files/Publication/401b051e-3cdd-4def-b39a-ff4d60399fbe/Presentation/PublicationAttachment/2fed2849-3dc2-4f70-8ecf-6f192dab22b4/Schneider_Judgment2002-10-22_bulletin.pdf

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