
European Court of Justice Overturns CFI's *Impala* Judgment and Restores Proper Process in EC Merger Review

2008-07-14

On July 10, 2008, the European Union's highest court, the European Court of Justice (ECJ), overturned a 2006 judgment by the Court of First Instance (CFI) concerning the merger of Sony and Bertelsmann Music Group's (BMG) recorded music businesses. The CFI's 2006 judgment annulled the Commission's 2004 decision to clear the transaction following an appeal by complainant Impala.

The ECJ's judgment is significant in a number of respects. Most importantly, it emphasizes that the "Statement of Objections" (SO) is only a provisional procedural document in competition cases and does not carry any evidentiary weight of its own. The ECJ clarifies that the Commission abandoning its objections in light of the parties' response should not be cause for increased judicial scrutiny, but rather is compatible with the SO's very purpose of ensuring the rights of defense. These pronouncements not only restore the previous procedural dynamics to EC merger reviews, but also limit the potential for the misuse of SOs in other contexts, for example by plaintiff lawyers in private cartel follow-on actions.

In addition, the ECJ has for the first time endorsed in substance the CFI's *Airtours* criteria for determining collective dominance, although it uses slightly different language and emphasizes the need to avoid mechanically applying the three factors in the *Airtours* test.

In institutional terms, the judgment is a rare example of the ECJ overruling the CFI in a competition case. Coupled with the ECJ not following Advocate General Kokott's opinion recommending upholding the CFI's judgment, this may signal that the ECJ has a greater willingness to take a more active role in competition cases at least when fundamental issues such as rights of defense are at stake.

Background

In January 2004, Sony and BMG notified to the European Commission a joint venture to integrate their recorded music businesses. After an in-depth (Phase II) investigation, the Commission approved this transaction in July 2004. In December 2004, Impala, an international association of independent music production companies, appealed this decision. (Impala had already expressed

its concerns during the Commission's proceeding.) The CFI annulled the Commission's clearance decision, holding that it contained manifest errors of assessment and inadequate reasoning.¹ The parties appealed the CFI's judgment to the ECJ, with the Commission supporting most of their arguments. The hearing before the ECJ's Grand Chamber took place in November 2007. In December 2007, Advocate General Kokott recommended that the appeal be dismissed.²

Since the parties' appeal to the ECJ did not have suspensory effect, in January 2007 they also updated and re-filed their merger notification to the Commission. In October 2007, after conducting another in-depth investigation based on then-current market conditions, the Commission adopted a fresh decision authorizing the merger without conditions.³ This investigation was reportedly one of the most extensive the Commission had ever undertaken. Nevertheless, in June 2008, Impala announced that it had yet again appealed the Commission's decision to the CFI.

The ECJ's Judgment

The appellants' arguments concerned four main issues: (i) the Commission's assessment of evidence and its standard of proof in merger cases, in particular the significance of the SO and of the parties' evidence supplied in rebuttal; (ii) the concept of a collective dominant position; (iii) the scope of the CFI's judicial review of mergers; and (iv) the adequacy of the Commission's reasoning in the 2004 clearance decision. The ECJ's most significant holdings are as follows:

The Role of the Commission's SO

In its 2006 judgment, the CFI compared the Commission's provisional findings in the SO with its subsequent clearance decision and criticized the Commission's unexplained "fundamental U-turn" in abandoning its concerns that the transaction would strengthen a pre-existing position of collective dominance. For the CFI, this demonstrated a failure to adequately reason its decision and manifest errors of assessment. The CFI paid only lip service to the previous jurisprudence holding that an SO is a provisional, preparatory document whose main purpose is to set out the scope of the Commission's case against the merging parties and thus ensure respect of their rights of defense.

In her opinion, the Advocate General expressed discomfort with some of the CFI's statements regarding the role of the SO. She nonetheless ultimately concluded that the CFI's specific references to discrepancies between the SO and the final decision were not central to the CFI's conclusion that the Commission's reasoning was insufficient and its assessment vitiated by manifest errors.⁴

The ECJ, however, sent a strong message to the CFI on this point. The ECJ singled out various references in the CFI's judgment to the Commission having to justify departures from "findings of fact made previously" in the SO. According to the ECJ, the CFI thus treated a particular category of conclusions in the SO as having actually been established rather than just provisional. Even if it were accepted that the CFI could generally distinguish between "findings of fact" and assessments based on those findings, the particular findings of fact in question (concerning the relevance of campaign discounts for market transparency) involved a complex economic assessment that the Commission should always be able to modify in its final decision. The ECJ ruling emphasizes the SO's legal significance as safeguarding the parties' rights of defence and recognizing--in

substance--the practical reality that SOs are often drafted as advocacy documents to test the strength of the case team's arguments. In doing so, the ECJ restores the institutional dynamics in EC merger review proceedings that existed before the CFI's judgment. This is a welcome development. As a predictable⁵ consequence of the CFI's judgment, the Commission has foregone issuing an SO even in complex and controversial phase II merger cases such as *Universal/BMG*, *Thomson/Reuters* and *Google/DoubleClick*, lest an SO bind its ultimate decision. This is detrimental not only for third parties such as *Impala*, whose interests the CFI was presumably trying to protect, but also for the merging parties, who often have had to produce extensive economic evidence or submit remedies proposals without knowing the precise nature of the case team's concerns or the strength of its underlying evidence.

The ECJ's emphasis on the preparatory and provisional character of an SO should also be helpful in cartel cases. Whereas the merger review process is usually characterized by an ongoing dialogue between the parties and the Commission, companies caught in a cartel investigation typically learn the full extent of the allegations only through the SO and are only then able to prepare a proper defense. In such circumstances, it is even more important for the Commission not to feel unduly bound by its allegations in the SO as it moves to a final decision. Moreover, the ECJ's recognition concerning the SO's extremely limited probative value should help curb the misuse of SOs in civil litigation, particularly by plaintiffs in US cartel cases. Plaintiffs frequently seek to obtain SOs through discovery, often to use them in trying to extract lucrative settlements with defendants.

The Significance of Evidence Submitted in a Reply to an SO

The CFI had reproached the Commission's decision for being overly reliant on evidence that the parties had submitted in their reply to the SO and criticized the parties for having "waited until the last minute" before supplying such evidence. According to the CFI, the Commission should not have "delegated" its investigation to the parties in this manner. Rather, it should have carried out its own investigation of the relevant facts, even if this meant having to send questionnaires to third parties late in the proceedings.

The CFI's ruling risked paralyzing an already compressed merger review timetable, which gives the Commission little time to carry out a further comprehensive market investigation after an oral hearing and reply to an SO. The ECJ recognized this and rejected the CFI's requirements for routine further investigation. If the parties' evidence is sufficiently strong to rebut the Commission's arguments in the SO, the Commission can rely on that evidence and should not subject it to more exacting standards than the arguments of competitors, suppliers, customers or other third parties submitted earlier in the proceeding.

The ECJ's ruling on the significance of evidence submitted by the parties in response to the SO again suggests a better understanding of the realities of the merger review process than is evident from the CFI's judgment. The merging parties cannot be properly blamed for having failed to anticipate exactly what evidence the Commission may be relying on in its SO. Nor is there any reason to believe that the evidence that the merging parties submit at the SO response stage is any less reliable, unbiased, or complete than that submitted earlier by third parties. Indeed, that the Commission has considerably more leverage over the merging parties than it has over third parties

means that the parties bear a great risk if they provide misleading information and have strong incentives not to do this.

The Concept of Collective Dominance

In its 2006 judgment, the CFI found manifest errors in the Commission's assessment of collective dominance, or "coordinated effects" in today's EC merger parlance. In particular, it held that the Commission had wrongly relied on discount variations to show that the market was not transparent and therefore not conducive to tacit collusion. Furthermore, the CFI found that the Commission had provided insufficient reasoning for its conclusion that suppliers had no credible mechanism for retaliation against price cutters.

The ECJ's discussion is somewhat cryptic but, at the very least, seems to add some nuance to what had become the acceptable test for the creation or strengthening of a collective dominant position. In *Airtours*,⁶ the CFI had established three essential conditions for collective dominance: sufficient market transparency; sustainability of tacit collusion over time, which requires the existence of a credible retaliatory measure; and inability of third parties to jeopardize the tacit collusion.

Instead of simply adopting the *Airtours* test, the ECJ referred to *Kali & Salz*,⁷ an older ECJ case, which emphasized the existence of "correlative factors" linking oligopolistic market participants. Referring to the *Airtours* conditions, the ECJ observed that these "are not incompatible" with its view of the correct test for collective dominance, but "it is necessary to avoid a mechanical approach involving the separate verification of each of those criteria taken in isolation, while taking no account of the overall economic mechanism of a hypothetical tacit coordination." In particular, the ECJ notes that the assessment of market transparency can only be carried out "using the mechanism of a hypothetical tacit collusion as a basis." According to the ECJ, this requires that the Commission consider possible monitoring mechanisms when assessing if the market is sufficiently transparent for tacit collusion.

The ECJ ruled that, in forming a view about market transparency, the CFI had not correctly assessed whether credible monitoring mechanisms existed in the relevant market. In particular, the CFI had relied on Impala's unsupported assertions that the reasons for discount variations could be readily apparent to a (hypothetical) "industry professional."

Based on the Court's statements, it is hard to tell whether it meant to modify the *Airtours* test, or whether the distinctions are more semantic. The ECJ's criticism of the CFI's reliance on Impala's unsubstantiated claims might suggest a restrictive view of collective dominance as a theory of harm. At the same time, however, the ECJ did not object to the much-noted *obiter dictum* in the CFI's judgment stating that a finding of collective dominance need not always be grounded in a "theoretical" *Airtours*-type analysis, but may sometimes be inferred indirectly based on market performance. According to the ECJ, such an indirect analysis is not objectionable in and of itself, so long as it is "carried out with care" and adopts "an approach based on the analysis of such plausible coordination strategies as may exist in the circumstances."

Requirements for Adequate Reasoning of Commission Decisions

The ECJ also annulled the CFI's finding that the Commission had inadequately reasoned its clearance decision. The ECJ disagreed with the parties' (rather ambitious) argument that the default rule in Article 10(6) of the Merger Regulation--which stipulates that a merger is deemed approved if the Commission has failed to issue a decision within the applicable deadline--meant that a merger clearance decision could never be annulled for lack of reasoning. But it found that the Commission's decision was sufficiently reasoned because (a) Impala was able to ascertain the reasoning behind the Commission's decision and (b) the CFI was able to exercise effective judicial review.

Accordingly, the ECJ has, in substance, confirmed that pleas based on a failure to state reasons will rarely, if ever, be successful in merger cases. If such a plea is linked with a substantive criticism of the decision, this will be held to demonstrate that the purported lack of reasoning did not hinder the parties from exercising their rights of defense. On the other hand, a plea that is limited to a bare assertion that the decision lacks reasoning on an important point is unlikely to be compelling.

Other Legal Points in the Judgment

The ECJ's judgment includes a couple of other legal points that may also be of interest.

First, the ECJ agreed with the appellants that the CFI could not base its judgment on confidential information that Impala provided during the proceeding before the CFI, because the Commission itself could not have relied on it when adopting its decision. While not surprising, the ECJ's holding is a timely reminder for the Commission that it cannot rely on confidential or otherwise undisclosed information to justify the legality of its decisions before the CFI, as it has occasionally done when withholding other parties' replies to the SO in cartel cases.

Second, although the ECJ confirmed its holding in *Tetra Laval* that an appeal can be brought based on a contention that the CFI substituted its own economic assessment for that of the Commission and thus exceeded the permissible scope of its judicial review, it summarily rejected the argument that the CFI did so in this case. Instead, the ECJ pointed to those instances in which the CFI itself committed manifest errors of assessment or legal interpretation. Again, this approach is not surprising, but rather reflects a proper understanding of the division of tasks between the CFI and the ECJ. The ECJ clearly does not wish to deter the CFI from conducting a searching review of the factual record, and does not want to be burdened with arguments that the CFI performed that task too zealously--absent any evidence that it made outcome-determinative mistakes in doing so.

Conclusion

Both the Commission and the business community will welcome the ECJ's *Impala* judgment. The ECJ's judgment does not spell the end of litigation for Sony and BMG--following remand from the ECJ, the CFI now has two cases before it relating to the assessment of the same transaction under different market conditions. The judgment does, however, mark the happy end to an unfortunate interlude in EC merger control during which the Commission had to spend considerable time and resources and tweak its internal processes to try to make clearance decisions appeal-proof. Although there will certainly be future cases where third parties have a commercial incentive to attack clearance decisions, the ECJ's judgment at least reintroduces a modicum of confidence that

merger clearance decisions will be final in most cases. More generally, the ECJ's willingness to overturn a CFI ruling in such a significant case suggests that the ECJ still offers effective appellate review in competition matters, perhaps offering a glimmer of hope to those finding the CFI insufficiently responsive to concerns about procedure or substance in cartel or abuse-of-dominance cases.

¹For more detail on the CFI's judgment, see Völcker and O'Daly, *The Court of First Instance's Impala Judgment: a Judicial Counter-reformation in EU Merger Control?*, [2006] ECLR 589, available [here](#).

²Opinion of Advocate General Kokott of 13 December 2007 in Case C-413/06 P, available [here](#).

³Commission Decision of 3 October 2007 in Case M.3333 (4064), available [here](#).

⁴Opinion, 155-157 and 161-183

⁵Völcker and O'Daly, *The Court of First Instance's Impala Judgment: a Judicial Counter-reformation in EU Merger Control?*, cited above, at p. 594.

⁶Case T-342/99, *Airtours v. Commission*, CFI Judgment of June 6, 2002, available [here](#).

⁷Joined Cases C-68/94 and C-30/95, *France and Others v. Commission ('Kali & Salz')*, Judgment of March 31, 1998, para. 221, available [here](#).

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