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The *Impala* Judgment: Does EC Merger Control Need to Be Fixed or Fine-Tuned?

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In its *Impala* judgment last year, the Court of First Instance annulled a European Commission unconditional merger clearance decision for the first time. As a result, the Commission is having to carry out a new investigation into a transaction that closed over two years ago. In this judgment, the Court applied the three-limbed test for collective dominance from *Airtours* judgment. But this time it assessed strengthening, as opposed to creation, of collective dominance. Importantly, the Court made it clear that the Commission must base a clearance on equally solid grounds as a prohibition.

We examine a number of the fundamental issues that the *Impala* judgment has raised. These have significance beyond the factual context of the case itself, both for the way the Commission must conduct its investigations and for the role of judicial review by the EC courts. We conclude by suggesting some changes in Court and Commission practices that would, we believe, strengthen the effectiveness of EC merger control.

I. Introduction

On July 13, 2006, the Court of First Instance of the European Communities (CFI)¹ annulled the clearance² by the European Commission of the joint venture between Sony's and Bertelsmann's global recorded music businesses.³ This was the first (and so far only) time the CFI had overturned an unconditional Commission clearance decision under the EC Merger Regulation.⁴ As a result of the judgment, the Commission is having to carry out a new investigation into the SonyBMG joint venture, which has been in operation since August 2004. The CFI's judgment, which Sony and Bertelsmann have appealed to the European Court of Justice (ECJ),⁵ raises a number of fundamental issues for EC merger control that have significance beyond the factual context of the case itself and the way in which the Commission conducted that particular investigation.

II. The Commission's U-Turn

The *Sony/BMG* Decision appears to have been a remarkably reluctant clearance. Rather than explaining why the SonyBMG joint venture should be approved, the Decision concluded that the evidence was not sufficient to support a prohibition. The CFI held that the Decision had departed from the Commission's Statement of Objections (SO) without giving sufficient reasons for this change of mind, notwithstanding the arguments the Commission offered in support of its clearance during the court proceedings.

In its SO of May 24, 2004, the Commission had reached the preliminary view, based on strongly worded adverse findings of facts, that the SonyBMG joint venture would strengthen an existing position of collective dominance (coordinated effects) in both the physical and the online recorded music markets. Following the parties' response to the SO and an oral hearing that took place on June 14 and 15, 2004, the Commission reversed its position, described subsequently by the CFI as a "fundamental U-turn",⁶ and cleared the SonyBMG joint venture on July 19, 2004 without, however, fully explaining the reasons for the

1 Case T-464/04, *Independent Music Publishers and Labels Association (Impala) v. Commission* [hereinafter *Impala* or *Impala* judgment] (not yet reported) (2006).

2 Commission Decision 2005/188/EC [hereinafter the Decision], Case COMP/M.3333, *Sony/BMG* [hereinafter *Sony/BMG*], 2005 O.J. (L 62) 33.

3 Sony's activities in Japan were not contributed to the joint venture.

4 In 2001, the CFI annulled the unconditional clearance of a merger under the European Coal and Steel Community Treaty, in *RJB Mining v. Commission*, Case T-156/98, 2001 E.C.R. II-337.

5 Appeal brought on October 10, 2006, Case C-413/06 P, 2006 O.J. (C 326) 25.

6 *Impala*, *supra* note 1, at 283.

U-turn in its Decision. Rather, the Commission concluded that its “detailed analysis [...] showed some indications of coordinated behaviour which were as such, however, not sufficient to establish existing collective dominance”⁷ and approved the transaction on that basis.

On December 3, 2004, *Impala*, an association of independent music companies, lodged an application for annulment of the Decision, requesting that the CFI adjudicate the case under the expedited (or “fast-track”) procedure for merger appeals.⁸

III. The CFI’S Key Criticisms

As a court of review rather than appeal,⁹ the CFI’s task was not to rehear the facts of the case nor to establish whether the conditions of collective dominance in the recorded music industry were fulfilled, but to review how the Commission had conducted its investigation and reached its conclusions.

In its judgment, the CFI criticized the way the Commission had conducted its investigation and defended the Decision in court. In particular, the CFI held that

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the Commission’s finding that the transaction would not strengthen existing collective dominance was inadequately reasoned, and the CFI pointed out numerous inconsistencies between the Decision, the Commission’s SO and its submissions before the CFI. Although lack of reasoning would have been a sufficient ground, in itself, for annulment of the Decision, the CFI

also ruled that the Decision was vitiated by a manifest error of assessment in so far as “the elements forming the basis of the Decision did not constitute all the relevant data that must be taken into consideration and were not sufficient to support the conclusions drawn from them.”¹⁰

The CFI considered the Commission had ignored the elements of existing collective dominance previously postulated in its SO, and had based its clearance on insufficiently solid evidence—an error it could not rectify in the CFI proceedings. In particularly harsh terms, the CFI noted that the Commission “cannot

7 *Impala*, *supra* note 1, at 109.

8 Court of First Instance, Rules of Procedure, 2000 O.J. (C 34) 39, at art. 76a.

9 EC Treaty, at art. 230 (4).

10 *Impala*, *supra* note 1, at 542.

suppress certain relevant elements on the sole ground that they might not be consistent with its new assessment”¹¹ and that:

“explanations proffered during the proceedings before the Court or, a fortiori, checks relating to an essential aspect of the Decision cannot compensate for a lack of investigation at the time of the adoption of the Decision and eliminate the manifest error of assessment by which the Decision is thus vitiated, even if that error had no effect on the outcome of the assessment.”¹²

The CFI also criticized the fact that the analysis in the Decision concerning the possible creation (as opposed to strengthening) of collective dominance was “extremely succinct”¹³ and noted that the Commission’s “few observations, which are so superficial, indeed purely formal, cannot satisfy the Commission’s obligation to carry out a prospective analysis.”¹⁴

IV. *Airtours* Expanded?

Throughout its judgment, the CFI referred to the three-limbed test for the assessment of collective dominance, established in *Airtours*.¹⁵ Noting that the *Airtours* case law was originally developed in relation to the assessment of the risk of the creation of collective dominance (which entails an entirely prospective analysis), the CFI applied the *Airtours* criteria in the *Impala* judgment also to the strengthening of existing collective dominance. This, according to the CFI, requires “a concrete analysis of the situation existing at the time of the adoption of the Decision” and thus “must be supported by a series of elements of established facts, past or present, which show that there is a significant impediment of competition on the market.”¹⁶ In this respect, the CFI suggested, in an obiter dictum, that the existence of collective dominance (based on the three conditions of *Airtours*) could be established indirectly on the basis of “what may be a very mixed series of

11 *Id.* at 300.

12 *Id.* at 458.

13 *Id.* at 525.

14 *Id.* at 528.

15 Case T-342/99, *Airtours v. Commission* [hereinafter *Airtours*], 2002 E.C.R. II-2585.

16 *Impala*, *supra* note 1, at 250.

indicia and items of evidence relating to the signs, manifestations and phenomena inherent in the presence of a collective dominant position.”¹⁷ According to the CFI, price parallelism might be an indicator of collective dominance in some cases. In the absence of an alternative reasonable explanation:

“close alignment of prices over a long period, especially if they are above a competitive level, together with other factors typical of a collective dominant position, might [...] suffice to demonstrate the existence of a collective dominant position, even where there is no firm direct evidence of strong market transparency, as such transparency may be presumed in such circumstances.”¹⁸

In reviewing the Decision, the CFI focused on the first two limbs of the *Airtours* test: the degree of market transparency and the possibility of retaliation. The existence of countervailing factors (the third limb of the test) was not examined, as they were not covered in the Decision and, therefore, not part of *Impala*’s appeal.

The *Impala* judgment confirms that the *Airtours* test can be applied to strengthening of existing collective dominance as well as to the prospective analysis of creation of collective dominance.

IV. The SonyBMG Re-Examination: Old Rules Applied in a New Context

The CFI did not require the parties to dissolve their joint venture.¹⁹ Instead, the Commission is having to conduct a re-examination of the SonyBMG joint venture.

Sony and Bertelsmann parties re-notified their joint venture to the Commission on January 31, 2006—some six months after the *Impala* judgment.²⁰ As the original notification was made prior to May 1, 2004, when the revised EC Merger Regulation entered into force, the re-examination of the joint venture is

17 *Id.* at 251.

18 *Id.* at 252.

19 As a court of review, the CFI does not have powers to order this. The Commission may order the dissolution of an implemented merger if the merger has been declared incompatible with the common market (see Article 8(4) of the EC Merger Regulation).

20 2007 O.J. (C 29) 12.

governed by the procedural timetable and substantive “dominance” test of the previous EC Merger Regulation, but must take account of current market conditions. Interestingly and uniquely, this enables the Commission to assess the impact that the joint venture has had on competition over the past two and a half years since it started operating—the ultimate natural experiment!

The Commission’s re-examination is taking place in parallel with Sony and Bertelsmann’s appeal to the ECJ to overturn the *Impala* judgment. The re-examination is not suspended by the appeal (see Figure 1).

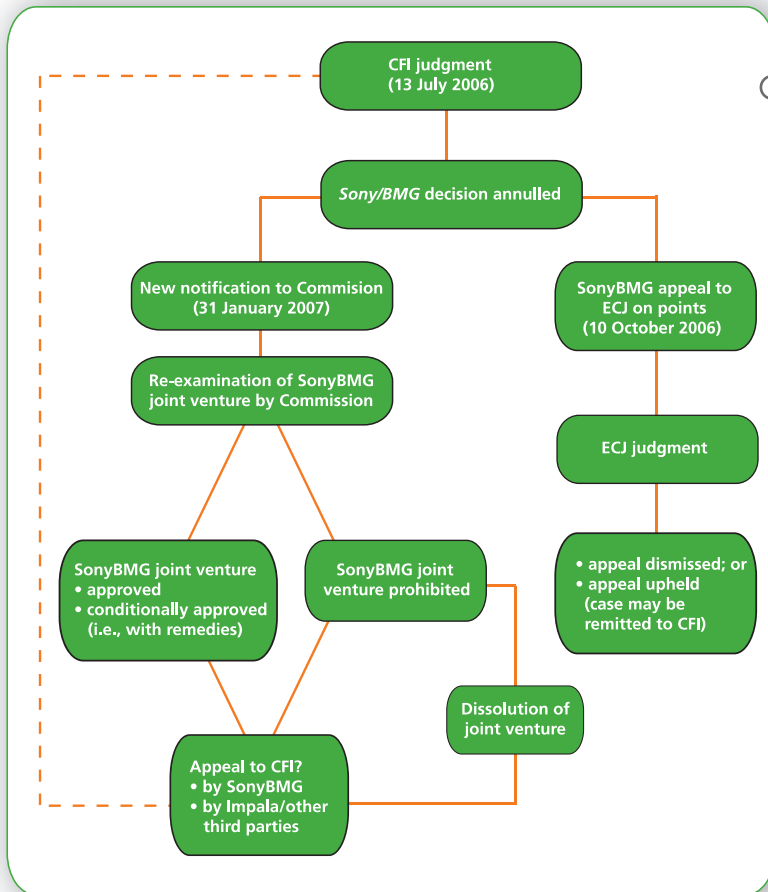


Figure 1

SonyBMG re-examination

V. Raising the Bar for EC Merger Approvals?

The *Impala* judgment sent shockwaves through the EC merger control regime, similar to those that followed the “trilogy” of CFI annulments of Commission prohibition decisions in 2002.²¹ While the *Impala* judgment is very fact-specific, it raises a number of questions that are of broader relevance to the way in which the Commission conducts its investigations.

First, does the Commission’s SO in effect constitute a benchmark for its final decision? The *Impala* judgment does not necessarily mean that the Commission’s preliminary findings in an SO on the facts and on their legal significance are set in stone. Indeed, the CFI recognized that the Commission “is not obliged to

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explain any differences by comparison with the statement of objections, since that is a preparatory document containing assessments which are purely provisional in nature.”²² But—some-what in contrast—the judgment does suggest it is incumbent on the Commission to justify any material departure from its initial objections, by refuting them on the basis of evidence that is “at the very least [...] particularly reliable, objective, relevant and cogent”.²³ Thus, if the Commission expresses its SO in strongly adver-

sarial terms, as it did in *Sony/BMG*, subsequent reversal of its position in the final decision may become more complicated and time-consuming than in the past. Alternatively, the Commission may refrain from adversarial SOs in the future.

Second, is the Commission now required to conduct a new market investigation following the merging parties’ response to the SO? The *Impala* judgment makes it clear that, to support a “U-turn”, the Commission cannot rely on information provided only by the merging parties without at the same time seeking views from third parties as that, in the CFI’s view, would amount to delegating “without supervision, responsibility for conducting certain parts of the investigation to the parties to the concentration.”²⁴ But, the standard EC Merger Regulation timetable does not allow for a meaningful further market investigation at such a late stage in the proceedings. Are we, therefore, going to see extended investigations in such circumstances?

21 *Airtours*, *supra* note 15; Case T-310/01, *Schneider Electric v. Commission* [hereinafter *Schneider*], 2002 E.C.R. II-4071; Case T-5/02, *Tetra Laval v. Commission* [hereinafter *Tetra (CFI)*], 2002 E.C.R. II-4381.

22 *Impala*, *supra* note 1, at 285.

23 *Id.* at 414.

24 *Id.* at 415.

Finally, has the CFI raised the standard of proof for merger clearance decisions? In the *Sony/BMG* Decision, the Commission concluded that it had not found sufficient evidence of competitive harm, and it therefore approved the transaction. But the CFI considered this was not enough. This raises an important question: is there a presumption in EC law that mergers are compatible with the common market? Advocate-General Tizzano in *Tetra Laval* indicated that there was when he said: “in the case of uncertainty as to whether or not the transaction is compatible with the common market, the interest of the undertakings seeking to make the merger must prevail.”²⁵

The CFI, in its *Impala* judgment, has not departed from this or reversed the presumption, thus requiring merging parties to demonstrate why their transaction should be approved, as some have claimed. But it has confirmed that the Commission must carry out its analysis with great care. This implies not only a requirement to base its analysis on “sound economics” and “hard evidence”, as the CFI famously stated in *Airtours*,²⁶ but also the need to conduct, and, as importantly, be seen to conduct, its investigations in a robust and unbiased way.

There are already signs that, as a matter of practice, the Commission may be changing its approach in light of the CFI’s *Impala* judgment. In particular, the Commission’s information requests in merger cases are becoming more lengthy and its merger analysis increasingly document- and data-intensive, increasing the burdens on both merging parties and third parties.

In *Impala*, the CFI did not address what the Commission should do if, notwithstanding a thorough investigation, the evidence does not clearly point one way or the other. This situation could arise increasingly as good counseling reduces the number of obvious prohibition cases that see the light of day.

VI. The Role of Judicial Review

The *Impala* judgment also confirms, once again, that, nowadays, judicial review is an integral part of EC merger review. An increasing number of high-profile merger decisions are challenged, whether by third parties or the merging parties, and the EC courts have been generous in accepting the admissibility of appeals against merger decisions.

25 AG Opinion (Tizzano) of May 25, 2004, Case C-12/03P, *Commission v. Tetra Laval* [hereinafter *Tetra (ECJ)*], 2005 E.C.R. I-987, at 79. According to Advocate-General Tizzano, by stipulating that, if the Commission does not make a decision in good time (see Article 10(6) of the EC Merger Regulation), then a concentration must be deemed to be authorized, the EC legislature demonstrates as a matter of fact that it considers that there is such a presumption. The ECJ did not, however, address this question in its judgment.

26 See *Airtours*, *supra* note 15; see also *Schneider*, *supra* note 21 and *Tetra (CFI)*, *supra* note 21.

Nevertheless, the judicial control exercised by the CFI and ECJ does not amount to a full appeal. It is limited to a review of the Commission's decisions based on limited grounds of annulment.²⁷ In their appeal to the ECJ, Sony and Bertelsmann have argued that the CFI exceeded the scope of judicial review by substituting its own assessment for that of the Commission. The ECJ has previously recognized that the provisions of the EC Merger Regulation:

“confer on the Commission a certain discretion, especially with respect to assessments of an economic nature, and that, consequently, review by the Community Courts of the exercise of that discretion, which is essential for defining the rules on concentrations, must take account of the margin of discretion implicit in the provisions of an economic nature which form part of the rules on concentrations.”²⁸

But, as the CFI pointed out in its *Impala* judgment,²⁹ the ECJ has also confirmed the importance of judicial review, stating that the Commission's margin of discretion “does not mean that the Community Courts must refrain from reviewing the Commission's interpretation of information of an economic nature.”³⁰

A key concern for the parties to a merger remains the ability to obtain judgment within a short time period. Although the expedited procedure was followed in *Impala*, it took 24 months from the Commission's decision on July 19, 2004 to the CFI's judgment of the CFI on July 13, 2006.³¹

The *Impala* judgment has reignited the debate about the need for a specialized EC competition court,³² or even the introduction of US-style merger litigation allowing for a full appeal, rather than limited judicial review, of Commission decisions.

27 EC Treaty, at art. 230 (4).

28 *Tetra (ECJ)*, *supra* note 25, at 38.

29 *Impala*, *supra* note 1, at 328.

30 *Tetra (ECJ)*, *supra* note 25, at 39.

31 Unusually, the CFI made *Impala* bear 75 percent of its own costs of the proceedings, as its behavior was found to be inconsistent with an expedited procedure.

32 Article 225a of the EC Treaty enables new tribunals to be established as courts of first instance for specific areas.

VII. Conclusion

The *Impala* judgment is a further chapter in the line of CFI cases that began with *Airtours*, confirming the Commission's duty to conduct its merger investigations thoroughly and to base its decisions on solid grounds backed by complete and accurate information. The judgment also confirms that merging parties are increasingly having to take account of the risk of litigation, and that third parties can play a significant role both during the Commission's investigation and before the EC courts. For the Commission, the challenge now will be to take the CFI's criticisms into account while still respecting the rights of all the parties involved in its investigations. Conducting U.S.-style merger investigations within the straightjacket of the EC Merger Regulation's timetable and subject to a requirement to write fully-reasoned decisions³³ may be asking the impossible of the Commission. In turn, this may lead to an increased willingness on the part of both the Commission and merging parties to settle difficult cases, potentially resulting in over-enforcement.

Rather than requiring a complete overhaul of the current procedures, however, some relatively small changes to the way the Commission conducts its merger investigations may contribute to the improved effectiveness of EC merger control. For example, by adopting an investigative approach, rather than an adversarial one (especially with regards to its SO), the Commission may avoid keeling over when taking a "U-turn". Similarly, some adaptations to the CFI's procedures, such as those relating to its working languages and its ability to enforce the accelerated timetable in merger cases, may go a long way to addressing the concerns that have been voiced following the *Impala* judgment. ▼

RATHER THAN REQUIRING A COMPLETE OVERHAUL OF THE CURRENT PROCEDURES, SOME RELATIVELY SMALL CHANGES TO THE WAY THE COMMISSION CONDUCTS ITS MERGER INVESTIGATIONS MAY CONTRIBUTE TO THE IMPROVED EFFECTIVENESS OF EC MERGER CONTROL. BY ADOPTING AN INVESTIGATIVE APPROACH, RATHER THAN AN ADVERSARIAL ONE, THE COMMISSION MAY AVOID KEELING OVER WHEN TAKING A "U-TURN".

³³ This is not a requirement in the United States, although the U.S. antitrust agencies sometimes issue a brief statement in relation to a merger clearance in important cases.