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# The European Commission's Reexamination of the *Sony/BMG* Merger: A Precedent-Setting Attempt to Jump the Fence

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Ben Van Rompuy, Institute for European Studies (VUB)

and

Caroline Pauwels, IBBT-SMIT (VUB)

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**I. INTRODUCTION**

On July 13, 2006, the European Court of First Instance (“CFI”) annulled the European Commission’s (“Commission’s”) decision authorizing the creation of Sony BMG, a joint venture incorporating the worldwide<sup>1</sup> recorded music businesses of Sony and Bertelsmann. In its 2004 clearance decision, the Commission had concluded that the merger would not create or strengthen a collective dominance position on the part of the majors (i.e., Universal, Sony BMG, Warner, and EMI).<sup>2</sup> In *Impala v. Commission*, however, the CFI harshly criticized the decision because it found that the evidence relied on by the Commission was not capable of substantiating this conclusion.<sup>3</sup>

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\* Ben Van Rompuy is a researcher at the Institute for European Studies (IES) in Brussels. He is working on a Ph.D. on the role of non-competition considerations in the European Commission’s Article 81 EC decisional practice related to the audiovisual and telecommunications sectors. Prof. Dr. Caroline Pauwels is director of SMIT (“Studies on Media, Information, and Telecommunication”), a research partner in IBBT. She lectures national and European communication policy in the department of communications at the Free University of Brussels.

<sup>1</sup> Except for Japan.

<sup>2</sup> Commission Decision of 19 July 2004, Case COMP/M. 3333 — Sony/BMG, 2005 O.J. (L 62) 30 [hereinafter *Sony/BMG*].

<sup>3</sup> Case T-464/04, Independent Music Publishers and Labels Association v. Commission, 2006 E.C.R. II-2289 [hereinafter *Impala*], *on appeal as* Case C-413/06 P, Bertelsmann and Sony Corporation of America v. Impala (not yet reported) [hereinafter *Impala II*].

Notwithstanding the fact that the European Court of Justice (“ECJ”) has now set aside *Impala* because of a number of identified errors of law, the judgment continues to raise fundamental questions about the standard of proof incumbent on the Commission when dealing with merger cases. The 2004 *Sony/BMG* decision indeed should be seen in light of the CFI’s consecutive annulment of three prohibition decisions in 2002: *Airtours v. Commission*,<sup>4</sup> *Schneider Electric v. Commission*,<sup>5</sup> and *Tetra Laval v. Commission*.<sup>6</sup> The resoluteness by which the CFI criticized the Commission for its analysis of the evidence and questioned the rigor of its decisions in these judgments was unprecedented. The three judgments, which were delivered over a five-month period, gave rise to a flood of criticism of the Commission’s merger analysis and opened a debate about the economic soundness of its decisions.<sup>7</sup> Moreover, they acted as a catalyst for a far-reaching reform of EC merger control, as former EC Competition Commissioner Mario Monti acknowledged that the judgments exposed significant errors:

I believe that, in a certain time, with more hindsight, we will say that these judgments, no matter how painful, came at the right time. Indeed, there are no doubt lessons to be drawn from the judgments: in particular, it is clear that the CFI is now holding us to a very high standard of proof, and this has clear implications for the way in which we conduct our investigations and draft our decisions.<sup>8</sup>

In this regard, the analysis that was undertaken by the Commission in the *Sony/BMG* case should have been characteristic for the more central role that was given

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<sup>4</sup> Case T-342/99, *Airtours v. Commission*, 2002 E.C.R. II-2585 [hereinafter *Airtours*].

<sup>5</sup> Case T-310/01, *Schneider Electric v. Commission*, 2002 E.C.R. II-4071 [hereinafter *Schneider*].

<sup>6</sup> Case T-5/02, *Tetra Laval v. Commission*, 2002 E.C.R. II-4381 [hereinafter *Tetra Laval I*].

<sup>7</sup> F.E.G. Diaz, *The Reform of European Merger Control: Quid Novi Sub Sole?*, 27 WORLD COMPETITION 177-99 (2004).

<sup>8</sup> M. Monti, *Merger control in the European Union: A radical reform*,” Speech given at the European Commission/IBA Conference on EU Merger Control, Brussels (Nov. 7, 2002).

to economics thanks to the merger control reform.<sup>9</sup> It was the first case in which the opinions of the newly appointed chief economist and its accompanying team of economists were sought. The 2004 *Sony/BMG* decision could furthermore be seen as an attempt to comply with the strong felt standard of proof imposed on the Commission by the Community Courts. Indeed, while the Commission expressed concerns about the high degree of concentration in the music industry, it concluded that the evidence available was “not sufficiently strong” to prove collective dominance and thus approved the merger.<sup>10</sup> The fact that the decision was annulled for not meeting the requisite legal standard for *authorizing* a merger, is therefore both ironic and challenging because it puts the Commission on a knife-edge.

After an in-depth reassessment of the Sony BMG joint venture, the Commission now strikes back with what EC Competition Commissioner Neelie Kroes calls “one of the most thorough analyses of complex information ever undertaken by the Commission in a merger procedure.”<sup>11</sup> In the recently published decision, taken in October 2007, the Commission again concludes that the transaction would not create or strengthen a dominant or collectively dominant position in the music markets in the European

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<sup>9</sup> G. Aigner, O. Budzinski & A. Christiansen, *The Analysis of Coordinated Effects in EU Merger Control: Where Do We Stand after Sony/BMG and Impala?* (working paper, University of Marburg) (2006), available at <http://ssrn.com/abstract=933548>; S. Baxter & F. Dethmers, *Collective Dominance Under EC Merger Control—After Airtours and the Introduction of Unilateral Effects is There Still a Future for Collective Dominance?*, 27 E.C.L.R. 151-52 (2006); N. Levy, *Mario Monti's Legacy in EC Merger Control*, 1 COMPETITION POL'Y INT'L 123-25 (2005).

<sup>10</sup> P. Eberl, *Following an in-depth investigation the Commission approved the creation of the Sony/BMG music recording joint venture on 19 July 2004*, 3 COMPETITION POL'Y NEWSLETTER 10 (2004).

<sup>11</sup> Press Release IP/07/1437, European Commission, *Mergers: Commission confirms approval of recorded music joint venture between Sony and Bertelsmann after reassessment subsequent to Court decision* (Oct. 3, 2007).

Economic Area (“EEA”).<sup>12</sup> As a precedent, the decision is of crucial importance for the Commission’s future handling of complex merger cases. At first sight, the recent judgment of the ECJ, which essentially refers the case back to the CFI without giving a final judgment in the matter, is not likely to turn the tide.

This article analyzes the new clearance decision in light of the *Impala* judgment and, subsequently, assesses whether or not *Impala* is imposing too high of a standard of proof on the Commission. It argues that the Commission has made a successful attempt to meet the Community Court’s standard, but that it is questionable that the Commission will be able to jump the fence again in a similar fashion under normal procedural circumstances. First, the article gives a brief overview of the previous case law on the standard of proof incumbent on the Commission in EC merger control. Second, the CFI’s criticisms on 2004 clearance decision are discussed, as well as the wider implications of *Impala* for the Commission’s evidentiary burden in the context of EC merger control. Third, the second clearance decision is analyzed in light of the *Impala* judgment.

## **II. THE STANDARD OF PROOF IN EC MERGER CONTROL: THE CASE LAW BEFORE *IMPALA***

Neither the old Merger Regulation nor the new ECRM make any reference to the standard of proof incumbent on the Commission in merger control, so it is necessary to look at the case law of the Community Courts for guidance. At the outset, it must be noted that a definite and precise standard of proof has yet to be articulated. Indeed, the Courts usually refer to the “requisite legal standard” without explaining how high that

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<sup>12</sup> With regards to EU Member States, the investigation was thus restricted to the 15 countries that were members before May 1, 2004. See *Sony/BMG*, *supra* note 2.

standard is.<sup>13</sup> Furthermore, it has been argued that, even though the use of the term “requisite legal standard” has remained consistent over the years, the application of this standard seems to tell a different story.<sup>14</sup>

In *Tetra Laval II*, the ECJ clarified that the evidence relied on needs to be “factually accurate, reliable and consistent,” should contain “all the information which must be taken into account in order to assess a complex situation,” and must be “capable of substantiating the conclusions drawn from it.”<sup>15</sup> Moreover, it stated that the Community Courts must verify whether the Commission has closely examined *all* the relevant circumstances.<sup>16</sup> As the CFI phrased it recently, it is not enough for the Commission to put forward a series of logical but hypothetical developments (which it fears would have harmful effects for competition):

Rather, the onus is on it to carry out a specific analysis of the likely evolution of each market on which it seeks to show that a dominant position would be created or strengthened as a result of the merger and to produce convincing evidence to bear out that conclusion.<sup>17</sup>

The Commission had claimed that the CFI, by requiring it to constitute “convincing evidence”<sup>18</sup> that a proposed merger “in all likelihood”<sup>19</sup> will give rise to

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<sup>13</sup> According to Sir Christopher Bellamy, a former president of the CFI, the reason for this must be sought in the different legal traditions of the EC judges. C. Bellamy, *Standards of Proof in Competition Cases*, in JUDICIAL ENFORCEMENT OF COMPETITION LAW 105 (1997).

<sup>14</sup> D. Bailey, *Standard of proof in EC merger proceedings: a common law perspective*, 40 COMMON MARKET L. REV. 845-88 (2003).

<sup>15</sup> Case C-12/03 P, Commission v. Tetra Laval, 2005 E.C.R. I-978 [hereinafter *Tetra Laval II*], at para. 39.

<sup>16</sup> Notwithstanding the value of these clarifications, Prete & Nucara (2005) deeply regret that the ECJ did not articulate a more precise and transparent test. See L. Prete & A. Nucara, *Standard of Proof and Scope of Judicial Review in EC Merger Cases: Everything Clear after Tetra Laval?* 26 E.C.L.R. 697-99 (2005).

<sup>17</sup> Case T-210/01, General Electric v. Commission, 2005 E.C.R. II-5575, at para. 429.

<sup>18</sup> See, e.g., *Tetra Laval I*, *supra* note 6, at paras. 155, 162, 223, 256 & 281.

significant anticompetitive effects in *Tetra Laval I*, imposed a disproportionate standard of proof for merger prohibition decisions that is “impossible to meet in practice.”<sup>20</sup> It took the view that this test differed substantially, both in degree and in nature, from the requirement to produce “cogent and consistent” evidence, as established by the ECJ in *Kali & Salz*.<sup>21</sup> The ECJ discarded the Commission’s arguments by stating that the CFI, in its call for a precise examination supported by “convincing evidence”: “by no means added a condition relating to the requisite standard of proof but merely drew attention to the essential function of evidence, which is to establish convincingly the merits of a decision on a merger.”<sup>22</sup>

Both *Tetra Laval* judgments essentially recapitulate the principle that, where the Commission finds that a concentration would lead to a situation in which effective competition in the common market is significantly impeded, it is incumbent on it to provide cogent, consistent evidence thereof. This is the standard that was set out by the ECJ in *Kali & Salz*—a standard that was, although considered to be high, instantly recognized by the Commission in *Price Waterhouse/Coopers & Lybrand*.<sup>23</sup>

With regards to the prospective analysis, the ECJ acknowledged that merger control requires a difficult assessment of the way in which a proposed concentration might alter the factors determining the level of competition on a given market. Since this

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<sup>19</sup> *Id.* at para. 153.

<sup>20</sup> Press Release IP/02/1952, European Commission, Commission appeals CFI ruling on Tetra Laval/Sidel to the European Court of Justice (Dec. 20, 2002).

<sup>21</sup> Case 30-95, France and others v. Commission, 1998 E.C.R. I-1375 [hereinafter *Kali & Salz*], at para. 228.

<sup>22</sup> *Tetra Laval II*, *supra* note 15, at para. 41.

<sup>23</sup> Commission Decision of 20 May 1998, Case IV/M.1016 — *Price Waterhouse/Coopers & Lybrand*, 1999 O.J. (L 50) 27.

entails a prediction of events, and not an examination of current or past events (as is the case for antitrust investigations), this analysis needs “to be carried out with great care.”<sup>24</sup> Furthermore, it makes it necessary “to envisage various chains of cause and effect with a view to ascertaining which of them are *the most likely*.”<sup>25</sup> (emphasis added) This explicit reference to the standard of probabilities confirms that a higher standard of proof applies for a potential, rather than existing, (collective) dominant position.

### **III. THE 2004 CLEARANCE DECISION AND THE *IMPALA* RULING**

In January 2004, Sony and Bertelsmann notified their plans to merge their recorded music businesses to the Commission. The proposed concentration was still assessed under the old Merger Regulation: Regulation 4064/89.<sup>26</sup> Because the Commission found that the transaction raised serious collective dominance concerns, it decided to initiate an in-depth investigation.<sup>27</sup> This hardly came as a surprise: the Commission had already entertained similar concerns in the context of the 1998 merger between Seagram and Polygram, which reduced the number of majors from six to five, and in the context of the withdrawn *EMI/Time Warner* merger.<sup>28</sup> Yet, in light of the parties’ response to the statement of objections, the Commission remarkably changed its

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<sup>24</sup> *Tetra Laval II*, *supra* note 15, at para. 43.

<sup>25</sup> *Id.* at para. 43.

<sup>26</sup> European Commission, Council Regulation (EEC) 4064/89 of 21 December 1989 on the control of concentrations between undertakings, 1989 O.J. (L 395) 13.

<sup>27</sup> Press Release IP/04/200, European Commission, Commission opens in-depth investigation into Sony/Bertelsmann recorded music venture (Dec. 12, 2004).

<sup>28</sup> Commission Decision of 21 September 1998, Case IV/M.1219 — *Seagram/Polygram*, 1998 O.J. (C 309) 8, at paras. 26 & 29; The fact that EMI and Time Warner gave up the merger was not only due to the Commission’s alarming preliminary conclusions, but should also be seen as a concession to enable Time Warner and AOL to merge. H. Ranaivoson, *Cultural Diversity and Competition Policy in the Recording Industry*, Paper presented at the Fourth International Conference on Cultural Policy Research (Jul. 12-16, 2006), at 8.



position and eventually cleared the merger in its July 19, 2004 decision.<sup>29</sup> After the approval of the merger by competition authorities around the world (e.g., the United States, Australia, Canada, Switzerland, Poland, and South Africa),<sup>30</sup> the Commission thus too gave green light for the creation of Sony BMG, a fully functional (50-50) joint venture incorporating the parties' activities in the discovery and development of artists<sup>31</sup> and in the marketing and sale of sound recordings.

### **A. Evidence in the 2004 Clearance Decision and the CFI's Criticisms**

The Commission's findings relating to market transparency and the use of retaliation formed the essential grounds of the first clearance decision. These two elements constitute the most prominent criteria of the substantive test that was put forward by the CFI in *Airtours*. For a finding of collective dominance, the CFI clarified that it must be established that:

1. there is sufficient market transparency so to allow spotting deviations;
2. there are adequate deterrents to ensure that there is an incentive not to depart from the common policy; and
3. the benefits of coordination are not jeopardized by the action of current and future competitors or consumers.<sup>32</sup>

The Commission concluded that—notwithstanding the existence of factors conducive to collusion—there was insufficient evidence to establish that the concentration would lead

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<sup>29</sup> *Sony/BMG*, *supra* note 2.

<sup>30</sup> Not to mention, the Czech Republic, Hungary, Romania, and Mexico. *See Impala*, *supra* note 3, at para. 229.

<sup>31</sup> These are the so-called Artist & Repertoire (“A&R”) activities, in essence the music industry's research and development.

<sup>32</sup> *Airtours*, *supra* note 4, at para. 62.

to a creation or strengthening of a collective dominant position on the markets for recorded music or for licenses of online music. As stated above, this decision was annulled by the CFI in 2006. The Court not only criticized the decision for its overall lack of evidence, but also held that the available evidence, as mentioned in the decision, is not capable of supporting the conclusions drawn from them. According to the CFI, the decision at the most provides observations that are “superficial, indeed purely formal.”<sup>33</sup>

To assess the degree of market transparency in the market for recorded music, the Commission examined whether coordinated price policy of the majors could be identified. For this purpose, price developments over the last three to four years were considered (with a particular focus on the United Kingdom, France, Germany, Italy, and Spain). The Commission further examined the development of the average wholesale net prices for the top 100 albums of each year, whether any parallelism could have been reached on the basis of published prices to dealers (PPDs), and whether the different major’s discounts were aligned and sufficiently transparent.

On the basis of the average net prices, the Commission found some parallelism and a relatively similar price development of the majors. It also found that PPDs are transparent enough to enable monitoring of other major’s list pricing. Nevertheless, the Commission concluded that these observations could not constitute sufficient evidence of coordinated pricing behavior in the past. Moreover, it reasoned that certain deficits in the transparency of campaign discounts render the market opaque (so that price coordination would require further monitoring on the level of individual albums). In the Commission’s

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<sup>33</sup> *Impala*, *supra* note 3, at para. 528.

view, it could not be established that the publication of hit charts nor Sony and BMG's weekly sale reports ensured the necessary degree of transparency of competitor's campaign discounts. Given the fact that that no real evidence was found that the reduction of major recording companies from five to four would significantly facilitate transparency, the Commission accordingly concluded that the concentration was also not likely to create a dominant position.

In the *Impala* judgment, the Court pointed out that the Commission principally mentioned factors that "far from demonstrating the opacity of the market, show, on the contrary, that the market was transparent."<sup>34</sup> It particularly emphasized that the observed sources of price transparency (e.g., the public nature of PPDs and the limited number of reference prices) are capable of giving rise to a high level of transparency. The Court furthermore dismissed the finding that list prices of albums are rather aligned as a "prudent conclusion to say the least" since "the alignment was in fact very marked."<sup>35</sup> Subsequently, the CFI heavily criticized the Commission for countering these sources of transparency with the "rather limited and unsubstantiated" assertion that campaign discounts could reduce transparency and make tacit collusion more difficult.<sup>36</sup>

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<sup>34</sup> *Id.* at para. 290.

<sup>35</sup> *Id.* at para. 299.

<sup>36</sup> *Id.* at para. 294. The Court invalidated the Commission's reasoning in a forceful manner:

Clearly, such vague assertions, which fail to provide the slightest detail of, in particular, the nature of campaign discounts, the circumstances in which such discounts might be applied, their degree of opacity, their size or their impact on price transparency, cannot support to the requisite legal standard the finding that the market is not sufficiently transparent to allow a collective dominant position.

*Id.* at para. 289.

After a thorough review of the findings relating to market transparency, the CFI briefly examined the Commission's assessment concerning retaliation. The Commission identified two measures that could represent possibilities for retaliation against any "cheating" major,<sup>37</sup> but found no evidence that such means have been used or threatened in the past.

The CFI observed, however, that the Commission was not in a position to indicate the slightest step it had undertaken to substantiate this assertion. Furthermore, the CFI disagreed with the Commission's view that it was necessary to establish the absence of retaliatory action. On the contrary, it held that the mere existence of punishment mechanisms is in principle sufficient. Hence, the CFI concluded that the analysis in the decision relating to retaliation is, like the one relating to market transparency, vitiated by an error of law and a manifest error of assessment.

### **B. Implications of *Impala* for the Standard of Proof**

As already indicated, *Impala* addresses several significant issues related to the standard of proof that are of wider relevance for EC merger control. In what follows, these consequences will be identified and evaluated. First and foremost, *Impala* imposes a symmetrical standard of proof on the Commission for clearance and prohibition decisions. Second, *Impala* confirms that there is a different standard of proof for finding an existing or potential collective dominance position. Third, *Impala* further complicates the already time-constrained and complex administrative procedure for handling concentrations. After a discussion of these general implications of *Impala*, it will be

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<sup>37</sup> These include (1) a return to competitive behavior or (2) the exclusion of the deviator from compilation joint ventures (e.g., the refusal to license tracks for the deviator's compilation albums).

analyzed how the Commission addressed them in its reexamination of the Sony BMG concentration.

### *1. Symmetrical standard of proof*

The *Impala* judgment first of all (and perhaps most importantly) makes clear that the standard of proof the CFI requires the Commission to satisfy equally applies to prohibition and clearance decisions. This is of great importance for future merger control analysis, as it makes clear that the Commission will always have to make a strong case one way or the other. Contrary to some commentators,<sup>38</sup> the authors believe that this is a logical and positive development in the case law.

The discussion about the desirability of a symmetrical standard of proof is underpinned by a broader yet closely related issue, namely the question whether there exists (or should exist) a bias against or in favor of the legality of mergers. In his opinion in *Tetra Laval II*, Advocate General (“AG”) Tizzano argued that there should be a presumption of the mergers’ compatibility with the common market especially when it is difficult to foresee the effects of the notified transaction (so-called “grey-area” cases). Two main arguments were put forward. First, he referred to Article 10(6) of the old Merger Regulation, which stipulates that if the Commission does not take a decision within the time limits set, the notified merger “shall be deemed to have been declared compatible with the common market.” According to AG Tizzano, this clearly demonstrates that, in the case of uncertainty, the Community legislature preferred to run the risk of authorizing a transaction that is incompatible with the common market.

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<sup>38</sup> See, e.g., Aigner et al. (2006), *supra* note 9; M. Collins, *The burden and standard of proof in competition litigation and problems of judicial evaluation*, 5(1) ERA FORUM 66-83 (2004); and Prete & Nucara (2005), *supra* note 16.

Second, he argued that a bias towards authorization is justified because the Commission and the national competition authorities still have the opportunity to intervene ex post on the basis of the EC antitrust rules.<sup>39</sup>

Contrary to AG Tizzano's view, the authors contend not only that there is no clear legal basis to assume prima facie that a merger is lawful, but moreover that such a presumption would go against the underlying rationale of EC merger control. Indeed, the assertion that the Merger Regulation carries a built-in presumption in favor or against mergers is flawed. The symmetrical nature of the legal requirements laid down in Articles 2(2) and (3) of the Merger Regulation—devoted to the prohibition and the approval of mergers respectively—logically implies that the evidentiary obligation should be equal. In *General Electric*, the CFI expressly confirmed this by stating that the Commission must not find in favor of a concentration in case of doubt, but rather must always make an actual decision one way or another.<sup>40</sup> Finally, it must be stressed that AG Tizzano's reliance on the text of Article 10(6) of the Merger Regulation is not convincing. It is true that a merger will be deemed to have been declared compatible if the Commission fails to take a decision within the prescribed deadlines. However, this will only result in an implied decision that still can be appealed.<sup>41</sup> Moreover, it would be wrong to overestimate the importance of Article 10(6) ECMR, as this is mainly a built-in protection for the parties against a Commission's failure to act in time.

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<sup>39</sup> Opinion of Advocate General Tizzano, *Tetra Laval II*, *supra* note 15, at paras. 78-81.

<sup>40</sup> *General Electric*, *supra* note 17, at para. 61.

<sup>41</sup> One example is an action under Art 288 EC for maladministration.

In *Impala*, the CFI refrained from taking a clear stance in the debate on the alleged presumption in favor of the legality of mergers. The ECJ, on the contrary, expressly confirmed that there is no general presumption that a notified merger is (in)compatible with the Common Market.<sup>42</sup> The symmetrical standard of proof may pose problems for the Commission when it is confronted with ambiguous evidence. However, as ECJ AG Kokott indicated in her opinion in *Impala*, there can only be a few small and infrequent “grey-area”, borderline cases in which, even after extensive market investigations, it is not clear on which side of the line the case falls.<sup>43</sup> Arguably in these cases the concentration may be presumed to be compatible with the common market. It would be wrong, however, if the Commission would opt by default for a clearance decision in any case of doubt. Indeed, an unequal standard of proof in favor of clearance may in practice lead to the undue authorization of anticompetitive mergers. This was precisely the fear that was raised in the aftermath of the *Airtours*, *Schneider*, and *Tetra Laval I* judgments in 2002. It can even be considered that it was in light of this jurisprudence that the Commission—aware of the high standard of proof and the intensity of judicial review—concluded that the evidence was “not sufficiently strong” to underpin a prohibition decision in the *Sony/BMG* case.<sup>44</sup> We therefore welcome the symmetrical standard of proof, as this ensures that the Commission will always take a fully reasoned

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<sup>42</sup> *Impala II*, *supra* note 3, at paras. 46-53.

<sup>43</sup> Opinion of Advocate General Kokott, *Impala II*, *supra* note 3, at para. 139.

<sup>44</sup> F. Polverino, Assessment of Coordinated Effects in Merger Control: Between Presumption and Analysis (working paper, University of Chicago Law School) (2006), available at <http://ssrn.com/abstract=901688>.

decision based on sound evidence—a standard that the first clearance decision clearly did not meet.

## ***2. Existing or potential collective dominant position***

The discussion of the previous case law on the standard of proof made clear that there is a difference between the standard of proof for finding an existing or potential collective dominant position. The CFI confirmed this by lowering the evidentiary threshold for satisfying the *Airtours* conditions in the context of an existing collective dominant position.

First, the CFI observed that the existing case law on collective dominance was developed in the specific context of the assessment of the possible *creation* of a collective dominant position. It stressed that in this case the Commission is required to carry out a “delicate prognosis” with regards to the likely development of the market.<sup>45</sup> The appraisal of an existing collective dominant position is different, the Court argued, because here the Commission has the clear advantage that it can base its decision on “a series of elements of established facts, past or present.”<sup>46</sup> While this appears to be self-evident, it should be noted that the CFI used the distinction to suggest that the *Airtours* conditions could be more easily fulfilled in the case of a preexisting collective dominant position. Most remarkably, the CFI stated that:

[A]lthough the three conditions [...] are indeed also necessary, they may, however, in the appropriate circumstances, be established *indirectly on the basis of what may be a very mixed series of indicia and items of evidence* relating to the

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<sup>45</sup> Referring to *Kali & Salz*, the CFI furthermore highlighted that this analysis must consist of a close examination of the circumstances that are relevant for assessing the effects of the concentration on competition in the relevant market. *Impala*, *supra* note 3, at para. 250.

<sup>46</sup> *Id.* at para. 250.



signs, manifestations and phenomena inherent in the presence of a collective dominant position.

Thus, in particular, *close alignment of prices over a long period*, especially if they are above a competitive level, together with other factors typical of collective dominant position, *might, in the absence of an alternative reasonable explanation, 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 cases*.<sup>47</sup> (emphasis added)

This deviation from the original *Airtours* test can be seen as an explicit recognition of the difficulties the Commission may encounter when investigation complex collective dominance cases.<sup>48</sup> The CFI even suggested that in the case of the *Sony/BMG* merger, the alignment of prices over the last six years—together with other factors and in the absence of an alternative explanation—might indicate that this alignment is not the result of the normal play of effective competition and thus might suffice to demonstrate the existence of coordinated price behavior.<sup>49</sup> This illustrates that the *Airtours* conditions are not clear cut yet. Unfortunately, the same can be said about the CFI's teachings on the transparency criterion in *Impala* (e.g., the undefined “indicia and items of evidence” or the vague formulation of “appropriate circumstances”).

Second, and more specifically, the Court acknowledged that, in the context of an assessment of past coordination, the mere existence of retaliatory measures is in principle

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<sup>47</sup> *Id.* at paras. 251 & 252.

<sup>48</sup> See also A. Weitbrecht, *EU Merger Control in 2006 – The Year in Review*, 28 E.C.L.R. 128 (2007); and Damien Gérardin & Nicolas Petit, *The Antitrust Hotch Potch* blog (Aug. 20, 2006), available at <http://www.professorgeradin.blogs.com>.

<sup>49</sup> *Id.* at para. 253. As we have seen, the Commission did find that the market for recorded music displays certain features that indicate a conduciveness to collective dominance, but eventually cleared the merger because it believed that there was not sufficient evidence to conclude that a collective dominant position would be created or strengthened.

sufficient to fulfill the second *Airtours* condition.<sup>50</sup> What is more, the CFI considered that the Commission has to satisfy two cumulative elements before it can establish the absence of past retaliatory action:

1. there must be proof of deviation from the common policy, and
2. the Commission must be able to demonstrate the absence of retaliatory measures.<sup>51</sup>

By doing so, the CFI put forward two additional criteria that essentially elevate the evidentiary burden for the finding that the retaliation condition is *not* fulfilled.

#### ***4. Procedural implications of Impala for the Commission's investigation***

Two other elements of the judgment affected the evidentiary burden incumbent on the Commission in a less favorable way:

1. the CFI's criticisms as regards the Commission's reliance on the parties' data, and
2. the importance the CFI ascribed to the Statement of Objections ("SO").

The way in which the CFI reproached the Commission for basing its findings relating to campaign discounts solely on data relating to—and prepared by—the notifying parties, is a first notable aspect of the *Impala* judgment. While the CFI acknowledged that the Commission could not ascertain in the slightest detail the reliability of all the information submitted to it, it nevertheless stated that the Commission “cannot go so far as to delegate, without supervision, responsibility for conducting certain parts of the

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<sup>50</sup> The CFI stressed in this regard that there is no need to sanction if members of the oligopoly confirm with the common policy. Or, in other words, the most effective retaliation mechanism is that which has not been used. *Impala*, *supra* note 3, at para. 466.

<sup>51</sup> *Impala*, *supra* note 3, at para. 469.

investigation to the parties to the concentration.”<sup>52</sup> The downside of the CFI’s insistence on obtaining data from third parties, however, is that it adds an additional burden to an already time-constrained and complex merger review process. Moreover, the obtainment of such data is far from self-evident, as experience shows that third parties are generally reluctant to provide complete and reliable data on a timely basis, especially in the context of coordinated effects concerns. This is of course partly due to the fact that the relevant data often is commercially sensitive. The Commission indeed cannot issue a prohibition decision based on data that is not made accessible to the notifying parties without violating their right to reply.<sup>53</sup>

The second problematical aspect of *Impala*, namely the importance that was given to the SO, is even more significant because of its far-reaching procedural (and even substantial) implications for the Commission’s handling of merger cases. The SO is a normal procedural act in a second phase merger procedure that enables the parties to exercise their rights of defense. Article 18(1) ECMR stipulates that undertakings concerned have the right, at every stage of the procedure, to make their views on the Commission’s objections against the concentration.<sup>54</sup> For that reason, the Commission is

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<sup>52</sup> *Id.* at para. 415. The CFI found this to be particularly problematical in light of the observation that the alleged opacity constituted the crucial element on which the decision is based.

<sup>53</sup> S.B. Völcker & C. O’Daly, *The Court of First Instance’s Impala Judgment: A Judicial Counter-Reformation in EU Merger Control?* (Wilmer Hale Antitrust and EU Competition Briefing Series, No. 589-95, 2006), available at [http://www.wilmerhale.com/antitrust\\_and\\_competition](http://www.wilmerhale.com/antitrust_and_competition).

<sup>54</sup> This right is now further protected by the DG Competition’s Best Practices on the conduct of EC merger proceedings, which stipulates that the notifying parties must be offered a “state-of-play” meeting before the issuing of the statement of objections. This enables them to be informed of the type of objections the Commission may set out in its statement and thus enables them to understand the Commission’s preliminary view on the outcome of the investigation (*see* DG COMPETITION, BEST PRACTICES ON THE CONDUCT OF EC MERGER CONTROL PROCEEDINGS (2002), at para. 33(c)).

required to address these objections in writing to the notifying parties.<sup>55</sup> This is done by the issuance of a statement of objections, which sets forth the Commission's preliminary findings both on the facts and on their legal and economic significance.<sup>56</sup> This is of great importance, as the Commission can only base its decision on objections on which the parties have been able to submit their observations.

In its *Impala* judgment, the CFI acknowledged that the SO is a preparatory document containing assessments that are purely provisional. It highlighted, accordingly, that the Commission is not obliged to explain in its final decision any change in its position by comparison with that set out in the SO.<sup>57</sup> This is in line with the case law.<sup>58</sup> However, a careful reading of the *Impala* judgment makes clear that the CFI attributed a far more important role to the SO, despite all the attention it paid to the jurisprudence on this matter.<sup>59</sup> The ECJ likewise observed that the CFI treated certain conclusions set out in the SO as established rather than provisional and found this to be an error of law.<sup>60</sup>

Contrary to its final decision, the Commission had argued in its SO that the notified *Sony/BMG* merger was incompatible with the common market. As explained above, it provisionally concluded that the merger would strengthen a collective

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<sup>55</sup> European Commission, Commission Regulation (EC) 802/2004 of 7 April 2004 implementing Council Regulation 139/2004 on the control of concentrations between undertakings, 2004 O.J. (L 133) 1, at art. 13(2).

<sup>56</sup> J. COOK & C. KERSE, *EC MERGER CONTROL* (4<sup>th</sup> ed. 2005).

<sup>57</sup> *Impala*, *supra* note 3, at paras. 284-85.

<sup>58</sup> In *Aalberg Portland v. Commission*, for instance, the ECJ unequivocally stated that the Commission may, and even must, abandon objections that have been shown to be unfounded by the parties. Joined Cases C-204/00 P, C-205/00 P, C-211/00 P, C-213 P, C-217/00 & C-219/00 P, *Aalberg Portland and Others v. Commission*, 2004 E.C.R. I-123, at para. 67.

<sup>59</sup> Völcker & O'Daly (2006), *supra* note 53.

<sup>60</sup> *Impala II*, *supra* note 3, at para. 73.

dominance position (both in the markets for recorded music for online music licenses) and would coordinate the parties' behavior in a way incompatible with Article 81 EC. The CFI found this "fundamental U-turn in the Commission's position" surprising "particularly at the late stage at which it was made." It harshly criticized the Commission for not being capable of demonstrating how the previous findings were incorrect. In this regard, the CFI stressed that:

[U]nless the entire investigative administrative procedure is to be deprived from the slightest value, the Commission must be able to explain, not in the decision, admittedly, but at least in the context of the proceedings before the Court, its reasons for considering its provisional findings were incorrect.<sup>61</sup>

The CFI thus took the position that, while the Commission is entitled to modify provisional *assessments* made in the SO, the findings made in the decision must be compatible with the findings *of fact* made in the SO, in so far as it is not established that these findings were incorrect.<sup>62</sup> The authors agree with the ECJ that the CFI's remarks on the relationship between the decision and the SO cannot be minimalized as "unfortunate choices of expression."<sup>63</sup> The extent to which the CFI used the SO as a basis for its review of the first clearance decision remains unseen and has already had important consequences beyond the facts of this case. For example, it is notable that the Commission simply avoided the formal SO stage in about half of its recent merger proceedings, arguably as a direct response to the *Impala* judgment. The obvious drawback of this approach is that it seriously impedes the parties' rights to properly defend themselves, on the basis of all the necessary information, before the Commission

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<sup>61</sup> *Impala*, *supra* note 3, at para. 335.

<sup>62</sup> *Id.* at para. 446.

<sup>63</sup> A.G. Opinion (Kokott), *Impala II*, *supra* note 3, at para. 155.

adopts a formal decision. Another strategy was followed in *Ineos/BP Dormagen*.<sup>64</sup> After examining the parties' response to the SO, the Commission made use of its investigative powers under Article 11 ECMR to request information from competitors in order to assess the validity of the evidence that was submitted.<sup>65</sup> This approach also has tough limitations. Because of the mandatory time restrictions governing the adoption of decisions, there is very little room for conducting fresh investigations.<sup>66</sup> So whatever path the Commission will eventually prefer to follow—until the ECJ has delivered its judgment on *Impala* and perhaps beyond—it remains to be seen whether this will prove to be a positive procedural change.

#### **IV. THE REEXAMINATION OF THE *SONY/BMG* MERGER: A SECOND ATTEMPT TO CLEAR THE BAR**

The following section discusses and analyzes the Commission's new clearance decision in light of the *Impala* judgment.

##### **A. Evidence in the Second Clearance Decision**

After the case was re-notified to the Commission in January 2007, the Commission started a new assessment of the Sony BMG joint venture. Even though the new investigation was still carried out under the previous Merger Regulation—under which the Commission had to assess whether the merger would strengthen or create a

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<sup>64</sup> Commission Decision of 10 August 2006, Case COMP/M.4094 — *Ineos/BP Dormagen*, 2007 O.J. (L 69) 40. The Decision was taken in August 2006, only a few weeks after the *Impala* judgment. In this case, Ineos (a U.K.-based company active in the production, distribution sales, and marketing of chemicals) sought to acquire BP Dormagen Business (a Germany-based company active in the production of ethylene oxide and ethylene glycols).

<sup>65</sup> *Id.* at para. 4.

<sup>66</sup> Somewhat ironically, the CFI explicitly recognized that these time-constraints keep the Commission from extending its investigation. *Id.* at paras. 285 & 414.

collective dominant position in the EEA as it stood before May 1, 2004—the Commission decided to reexamine the transaction under current market conditions.<sup>67</sup> Consequently, the Commission was able not only to assess the actual impact of the merger but also to take into account the development of the digital music market since 2004. In 2004, this market was still in a state of infancy. This changed considerably as the majors have since then adopted their strategy with regards to digital sales. The new market investigation confirmed that, from both the demand side and supply side, this market can be distinguished from the physical market. The situations in both markets were therefore analyzed separately.

### *1. The market for recorded music in digital formats*

On the basis of market shares, the Commission at the outset concluded that the merger has not led to a position of single dominance in the national markets for digital distribution of music or to market foreclosure. Given the absence of non-coordinated effects, the Commission assessed whether the concentration has led to a creation or strengthening of a collective dominant position on the wholesale market for licensing of music to digital music providers. For this purpose, it conducted an in-depth investigation of both the contracts between the majors and the most important digital music service providers and of price developments in all the affected markets (for the period between 2004 and 2007). The pricing data showed that the majors apply different prices and price structures and use different business models: rather than coordination, record companies thus appear to individually maximize their returns on recorded music in digital form.

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<sup>67</sup> Press Release IP/07/272, European Commission, Mergers: Commission opens in-depth investigation into Sony/BMG recorded music joint-venture (Mar. 1, 2007).

With regards to market transparency, the Commission observed that digital retail market pricing is more standardized than in the physical market due to the importance of iTunes as a price setter that applies uniform prices (iTunes is the leading music provider worldwide with a market share in Europe of at least 50 percent) and due to the tendency of competing digital music providers to follow Apple’s “one-size-fits-all” pricing model. The market investigation moreover indicated that a number of elements considerably limit the ability of the majors to reconstruct wholesale prices or to identify any deviation regarding wholesale pricing on the basis of retail pricing. The Commission particularly pointed to the increasing diversity and complexity of wholesale pricing structures and agreements. As there are no PPDs in the digital market that could function as a focal point for coordination, the Commission concluded that there is not sufficient transparency to monitor whether the terms of coordinated are adhered to. No indications were found that changes could be attributed to the merger with regards to any increased transparency.

With regards to retaliation, the Commission found no credible deterrent mechanism for the majors to reinstate adherence any agreed collusive scheme. It emphasized that the wholesale prices of the majors vary considerably in opposite direction without any observable reaction of the majors.

With regards to countervailing abilities, the market investigation showed that independents exert only limited competitive pressure on the majors. Customers on the other hand could jeopardize to a certain extent the benefits of any coordination. iTunes in particular was found to have a strong impact on the recording companies’ pricing



structure decisions. According to the Commission, the creation of Sony BMG has not affected the balance of power that currently exist between the majors on the one hand and iTunes (and increasingly a number of other strong players, e.g., telecom operators) on the other.

## *2. The market for recorded music in physical formats*

To analyze the market for recorded music, the Commission widened its original examination of the *Sony/BMG* merger by asking for transaction data to evaluate and measure the impact of discounts on net wholesale prices. It collected from the four majors data related to all transactions of chart albums (for the period between 2002 and 2006) with their main customers in all affected national markets.

With regards to market transparency, the Commission scrutinized five theories of harm that have been suggested during the market investigation.<sup>68</sup> It assessed the criteria of transparency in each theory of price-related coordination, because each theory requires a specific level of transparency. The Commission considered that a coordination of mergers covering the prices of their new (chart) album releases is the most likely theory if coordination was to take place, as the bulk of sales of major recording companies are realized in the first weeks following the release. The investigation indicated, however, that the level of transparency (which characterizes PPDs, discounts, and markups applied to retail prices) does not permit a sufficient level of transparency. The study of the discount stability confirmed that, even in the hypothetical case of full transparency of

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<sup>68</sup> These include (i) coordination at the level of budgets; (ii) coordination at the level of each title pricing; (iii) coordination at the level of pricing policy (stabilization of current business model); (iv) coordination on prices at and shortly after the release date; and (v) coordination at the level of non-price terms. *Sony/BMG*, *supra* note 2, at paras. 530-634.

PPDs, a significant number of sales transactions do not follow a simple and stable pattern that could be inferred on the basis of public information.

With regards to retaliation, two potential mechanisms were evaluated:

1. the exclusion of the deviating company from compilation joint ventures or joint activities, and
2. the termination of the tacitly coordinated behavior with respect to prices and releases of albums.

The Commission reasoned that the absence of an observable alignment consistent with terms of coordination confirmed that these mechanisms are no credible means of retaliation.

With regards to countervailing abilities, the Commission again concluded that the independents are not likely to jeopardize the expected outcome from any coordinated behavior. Similar to the findings concerning the digital music market, it found that at least a sizeable proportion of customers (e.g., supermarkets) were on the contrary capable of destabilizing coordination by majors by reducing purchases and advertising on their products.

On the basis of all the above considerations, the Commission again concluded that there was no factual evidence to demonstrate that the notified operation would lead to a strengthening or creation of a collective dominant position on the online and offline markets for recorded music.

## **B. Some Comments on the New Market Investigation in Light of *Impala***

In its second clearance decision, the Commission made substantial attempts to address the CFI's criticisms voiced in *Impala*.

First, the new market investigation can rightly be called one of the largest and most complex econometric analyses conducted thus far in the context of EC merger control.<sup>69</sup> For example, in its first examination of the *Sony/BMG* merger, the Commission found some parallelism of the majors' average gross and net real prices in the markets for recorded music. It concluded, however, that these findings were not sufficient as such to establish existing price coordination, particularly because of the opacity of campaign discounts. The CFI harshly criticized this reasoning because the Commission had not investigated whether campaign discounts represent a sufficiently significant element of the price of albums to be capable of eliminating transparency. In response to the CFI's comments, the Commission widened its new market investigation to transaction data as a means to evaluate and measure the impact of discounts on net wholesale prices. It thus significantly extended its original analysis of the top 100 sales by collecting data on net prices, discounts, and wholesale prices for all CD chart albums sold by all majors in all of the 15 affected markets (equivalent to millions of data points). In addition to these quantitative aspects, it investigated the nature of discounts and the circumstances in which record companies use discounts to diminish their PPDs.

Second, the Commission fully embraced the points that were raised by the CFI concerning the *Airtours* test. The second clearance decision indeed repeatedly refers to

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<sup>69</sup> Press Release IP/07/1437, European Commission, Mergers: Commission confirms approval of recorded music joint venture between Sony and Bertelsmann after reassessment subsequent to Court decision (Oct. 3, 2007).

the *Impala* judgment to stress that, to satisfy the respective *Airtours* condition in the context of an existing collective dominant position, the mere threat to apply an effective deterrent mechanism is sufficient.<sup>70</sup> The Commission even went so far as to explore whether the three conditions could be established indirectly (see section III.B.2 above), even though the CFI clearly indicated that its statements in this regard were part of an obiter dictum.<sup>71</sup>

Third, the Commission clearly took the CFI's criticism that it had solely relied on data relating to and prepared by the notifying parties to heart. Third-party submissions were taken into account in all instances (i.e., information from other market players—both majors and independents, independent market observers, professionals, and so forth).

These observations indicate that the Commission has successfully attempted to satisfy the high standard of proof imposed by the CFI. There are already signs that the Commission is in fact adapting its overall approach in light of the annulment of the 2004 *Sony/BMG* decision. For instance, recent cases demonstrate that the Commission's requests for information are becoming increasingly lengthy and demanding.<sup>72</sup> It must be remembered, however, that the reassessment of the Sony BMG concentration is atypical in at least two ways. For one thing, the Commission was in a unique position to investigate the actual impact of the merger since it was already implemented one to three

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<sup>70</sup> *Sony/BMG*, *supra* note 2, at paras. 636, 725, 791, 860, 925, 982, 1046, 1509, 1162, 1215, 1269, 1325, 1381, 1435, 1489 & 1550.

<sup>71</sup> *Impala*, *supra* note 3, at para. 543.

<sup>72</sup> R. Brandenburger & T. Janssens, *The Impala Judgment: Does EC Merger Control Need to be Fixed or Fine-Tuned?*, 3 COMPETITION POL'Y INT'L 308 (2007).

years ago, depending on the territory. The need for a prospective analysis to evaluate the likelihood of the creation of a dominant position was therefore limited. What is more, the normal time pressure to adopt a decision was far less present. The new clearance decision was adopted 15 months after the annulment of the first decision, whereas a normal procedure has a tight schedule of 20 or 115 (in the case of a Phase II proceeding) working days. The update of the initial notification of the Sony BMG joint venture was only received in January 2007. Moreover, the Commission requested additional information from both the notifying parties as well as from the other majors pursuant to Article 11(5) of the Merger Regulation, which “stopped the clock” in the Phase II proceeding for another three months.<sup>73</sup>

The Commission’s reassessment of the Sony BMG joint venture should thus be seen in its right context. It is indeed doubtful whether the Commission could conduct a similar in-depth market investigation under normal procedural circumstances.

## **V. CONCLUSIONS**

The tsunami of judicial defeats in 2002 prompted the Commission to fundamentally reform its merger control review process as a means to improve the quality of its decisions (e.g., advancing the use of economic analysis). The annulment of the 2004 *Sony/BMG* decision, representative for the economic sophistication of merger control and the Commission’s more cautious approach towards prohibition, was therefore generally perceived as a crushing defeat. The analysis of *Impala* points out, however, that

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<sup>73</sup> *Sony/BMG*, *supra* note 2, at para. 6.

the judgment—certainly when seen in light of the recent ECJ ruling—is in fact a less-bitter pill for the Commission than some have argued.

The implications of *Impala* are certainly not without problems. The extent to which the CFI used the SO as a benchmark for its review of the decision is particularly troublesome. The fact that the ECJ heavily criticized the CFI for treating certain conclusions set out in the SO as established is therefore welcomed. A further problematic aspect of *Impala* is the CFI's insistence on obtaining data from third parties. Indeed, the Commission's increasingly lengthy and demanding information requests in the aftermath of *Impala* already illustrate the additional burden this adds, both for the Commission and the (third) parties, to the EC merger review process.

The analysis did not confirm, however, that *Impala* has significantly raised the standard of proof. The CFI in fact substantially lowered the evidentiary threshold for establishing an existing collective dominant position (even though its statements on the *Airtours* test are not unambiguous). Furthermore, *Impala* rightfully clarified that the standard of proof is equal for clearance and prohibition decisions. If anything, the 2004 *Sony/BMG* decision demonstrates the drawbacks of an asymmetrical standard of proof. Far from arguing why the merger would not lead to the creation or strengthening of a collective dominant position, the Commission mainly indicated why the evidence was “not sufficient” to underpin a prohibition decision. *Impala* therefore rightly confirms that the Commission cannot opt for a clearance decision to be on the safe side but rather must always take a fully reasoned decision based on sound evidence—a standard the first

clearance decision clearly did not satisfy. Hopefully, this will also reestablish the legal certainty that a clearance decision will be permanent, as the notifying parties have little control over ensuring that the Commission's analysis can withstand judicial scrutiny.

The reassessment of the Sony BMG joint venture is therefore of great strategic importance, as it has given the Commission a second chance to prove that it has the necessary resources and expertise to meet the Community Courts' standards. The analysis of the new clearance decision indicates that this attempt has been successful. It has been illustrated, for instance, that the investigation is based on a far more detailed and representative dataset and that extensive use was made of third-party submissions. However, this raises the question whether the Commission has set itself an impossible precedent with this decision. It is indeed doubtful that the Commission will be able to conduct such thorough investigation in a normal, very time-constrained merger review procedure. The observation that the Commission has avoided the formal statement of objections stage in several recent merger proceedings—arguably out of fear of judicial review—already seems to imply that the Commission itself is not entirely confident that it can jump the fence again in a similar fashion.