ECJ’s Sony BMG ruling restores clarity and confidence to European merger review

Summary

The recent Sony BMG judgment from the European Court of Justice ("ECJ")\(^1\) setting aside the July 2006 judgment of the Court of First Instance ("CFI")\(^2\) brings a long-awaited degree of clarity to a number of issues in the EC merger control process:

> the Commission is not obliged in its final decision to maintain the factual or legal assessments set out in the Statement of Objections ("SO");

> arguments and evidence provided by notifying parties in response to the SO are not subject to a higher standard of scrutiny than other arguments submitted to the Commission; and

> the judgment appears to confirm that the previous test for collective dominance in merger cases, as outlined in the \textit{Airtours} judgment, is the correct analytical approach.

In addition, the ECJ’s judgment affirms the Commission’s position that it is subject to the same burden and standard of proof for a clearance decision as for a prohibition decision, and appears to have made it increasingly difficult to complain successfully that a merger control decision is insufficiently reasoned.

These points are likely to prove helpful both to the Commission and to merging parties; as a practical matter the judgment may pave the way to a return of the Commission’s use of the SO in Phase II investigations.

Background

The ECJ judgment is the latest development in the long-running dispute relating to Sony BMG, the joint venture which combined the recorded music businesses of Sony and Bertelsmann:

> Sony BMG was unconditionally cleared\(^3\) in July 2004 following a lengthy Phase II investigation which included the issuance of an SO (and oral hearing); the parties’ response rebutted the Commission’s preliminary concerns that the merger would create or strengthen a collective dominant position between the remaining four major record companies (Universal, Sony BMG, Warner and EMI) in the market for recorded music and in the wholesale market for licences for online music.

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\(^1\) Case C-413/06, Bertelsmann AG and Sony Corporation of America v Impala, judgment of 10.07.2008.


\(^3\) Case M.3333, Sony/BMG, decision of 19.07.2004.
This clearance decision was overturned by the CFI\(^4\) on appeal by the Independent Music Publishers and Labels Association (“Impala”) on the basis that the Commission had made manifest errors of assessment in its investigation of the merger, and that the decision was inadequately reasoned.

One consequence of the annulment was that the Commission had to conduct a renewed investigation of the merger (which the parties had already put into effect in August 2004). Bertelsmann and Sony therefore updated their original notification of the joint venture to the Commission in February 2007; after a second Phase II investigation, the joint venture was unconditionally cleared again\(^5\). In June 2008 Impala appealed that second clearance decision to the CFI\(^6\).

In parallel with the update of the notification, Sony and Bertelsmann (the "Appellants") appealed the CFI’s judgment to the ECJ.

**The ECJ ruling**

The Appellants submitted seven interrelated pleas, alleging that the CFI had made various errors of law, including that it had: (i) inappropriately relied on the SO as a benchmark to review the Commission’s decision and required the Commission to undertake new market investigations following the response to the SO; (ii) applied an excessive and incorrect standard of proof for decisions approving a concentration; (iii) misapplied the *Airtours* test on establishing a collective dominant position; and (iv) applied an erroneous standard of reasoning for a clearance decision.

The ECJ ruled in favour of the Appellants on the majority of the pleas, and upheld the Appeal. The judgment contains a number of points of interest for merger control, which may be expected to impact on the Commission’s handling of Phase II investigations in the future.

**Statement of Objections and the notifying parties’ response to the SO**

In the context of a large number of references by the CFI in its judgment to the SO, and a criticism by the CFI of the Commission for not conducting "new market investigations in order to test the validity of … new conclusions" developed from the notifying parties’ response (CFI judgment, para 398), the ECJ emphasised the importance of the right to a fair hearing as a fundamental principle of Community law and recognised the time-constrained nature of the ECMR process.

Whilst the CFI noted the preparatory nature of the SO in its judgment, it nevertheless criticised the Commission for revising the preliminary assessments set out in that document. The ECJ was clear that, whilst the CFI is not precluded from using the SO to interpret a Commission decision, “the statement of objections does not prevent the Commission from altering its standpoint in favour of the undertakings concerned” (ECJ judgment, para 63). The CFI therefore committed an error of law in treating certain elements of the SO as being established, without demonstrating why they should have been considered as being established beyond doubt.

On a related point, the ECJ stated that “the notifying parties cannot, as a rule, be criticised for putting forward certain – potentially decisive – arguments, facts or evidence only in their arguments in reply to the statement of objections” (ECJ judgment, para 89), since it is only with the SO that the parties obtain a detailed insight into the Commission’s

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\(^5\) Case M.3333, Sony/BMG, decision of 03.10.2007.
\(^6\) Case T-229/08, Impala v Commission.
concerns. Given “the need for speed which characterises the general scheme of the Regulation” (ECJ judgment, para 90) the ECJ held that the Commission cannot be required to market test the response to the SO, nor can the arguments in the response to the SO be subject to “more demanding standards as to their probative value and their cogency than those imposed in relation to the arguments of competitors, customers and other third parties questioned by the Commission” (ECJ judgment, para 92).

The net result of these dicta should be a reduced reluctance on the part of the Commission to issue SOs in Phase II proceedings. Following the CFI’s 2006 judgment, the SO had all but been abandoned except in cases where the Commission was determined to issue a prohibition decision. Instead the Commission has tended either (a) to abandon its preliminary concerns and clear the case unconditionally at Phase II without issuing an SO, or (b) to use the threat of an SO (which could be viewed as a draft prohibition decision) to convince the notifying parties to offer formal divestment (or behavioural) commitments to enable the Commission to clear the case conditionally at Phase II without issuing an SO.

The ECJ’s judgment makes it clear that the issuance of an SO does not tie the Commission to the doubts it expresses, and that these doubts can effectively be rebutted by the notifying parties’ response without a subsequent market investigation (which would problematically compress the back end of the Phase II process).

The test for collective dominance

Whilst the CFI referred to the Airtours test in its judgment, it appeared to suggest that a collective dominant position might be inferred “indirectly on the basis of what may be a very mixed series of indicia and items of evidence relating to the signs, manifestations and phenomena inherent in the presence of a collective dominant position” (CFI judgment, para 251) – raising the question of an alternative test for collective dominance to that established in Airtours – and postulated the possibility of price transparency through the abilities of a market professional in reading through discount variations to determine net wholesale prices.

The ECJ appears to have ratified the three requirements for collective dominance previously established by the CFI in Airtours, although it did so by noting that the Airtours criteria7 used by the CFI in the Impala judgment are “not incompatible” with the following criteria:

> “There must be sufficient market transparency for each undertaking to be aware, sufficiently precisely and quickly, of the way in which the market conduct of each of the other participants in the coordination is evolving”;

> “Furthermore, discipline requires some form of credible deterrent mechanism that can come into play if deviation is detected”;

> “In addition, the reaction of outsiders, such as current and future competitors, and also the reactions of customers, should not be such as to jeopardise the results expected from the coordination” (ECJ judgment, para 123).

The ECJ did not criticise the CFI for taking into account evidence relating to the signs, manifestations and phenomena inherent in the presence of a collective dominant position. Indeed, the ECJ emphasised the need to take account of the overall economic mechanism of a hypothetical tacit coordination, rather than a “mechanical approach involving the separate verification of each of those criteria taken in isolation” (ECJ judgment, para 124).

7 Case T-342/99, Airtours plc v Commission. The Airtours test for collective dominance is threefold: (1) Is there sufficient transparency in the market to enable coordination? (2) Is there a credible retaliation mechanism to ensure that there is a long-term incentive in not departing from the common policy? (3) Can competitors and/or customers undermine the effects of the tacit collusion?
However, the ECJ was clear that the CFI could not rely on “unsupported assertions relating to a hypothetical industry professional” (ECJ judgment, para 132) to establish the existence of sufficient transparency in the marketplace. In misconstruing the principles that should have guided its analysis, the ECJ held that the CFI had committed an error of law.

It remains to be seen whether the ECJ’s judgment is interpreted by the Community judicature and the Commission as a straight affirmation of the Airtours test, or as a nuanced adjustment.

**Standard of proof**

Contrary to the arguments of the Appellants, the ECJ affirmed the Commission’s view that it faces a symmetrical standard of proof for a clearance decision as for a prohibition decision, drawing support from the similarities between the wording of Article 2(2) and 2(3) of the Merger Regulation (which lay out the tests for a clearance and prohibition decision, respectively). The judgment concludes that, whilst the Commission must adduce convincing evidence, its analysis should consist of “an examination of how a concentration might alter the factors determining the state of competition on a given market in order to establish whether it would give rise to a significant impediment to effective competition, [which] makes it necessary to envisage various chains of cause and effect with a view to ascertaining which of them is the most likely” (ECJ judgment, para 47 [emphasis added]).

**Standard of reasoning**

One of the CFI’s key criticisms of the Commission’s decision was that, whilst it contained a lengthy description of why the recorded music markets under investigation might be subject to tacit coordination, the explanation of the determinative reasons for clearing the case unconditionally was overly succinct; accordingly the CFI found that the Commission’s decision was insufficiently reasoned.

The ECJ held that the CFI had erred in law, finding that the decision did in fact contain sufficient reasoning since it showed the Commission’s reasoning sufficiently to allow Impala to challenge its validity before the CFI, and to enable the CFI to devote numerous paragraphs in its judgment to an analysis of whether those reasons were well-founded. The Commission was not obliged to include a detailed description of each of the factors underpinning its decision.

Given the brevity of the Commission’s reasoning in the decision for clearing the merger, the ECJ’s judgment appears to make it very difficult for an appellant before the CFI to plead successfully that a merger decision is insufficiently reasoned.

**Concluding remarks**

Because the CFI only addressed two of Impala’s five pleas in the original appeal, the ECJ has remitted the case back to the CFI for a second judgment (the CFI must follow the ECJ’s judgment on points of law). The CFI is likely to stay the proceedings in Impala’s second appeal while it reconsiders the first appeal.

Nevertheless, the ECJ’s judgment should have lasting consequences for the Commission’s investigations of future mergers.

**Sources**

Case C-413/06, Bertelsmann AG and Sony Corporation of America v Impala, judgment of 10.07.2008.

Merger Control

Notifications
1. **De Weide Blik/Atlanta** – Proposed acquisition by De Weide Blik NV, Belgium, of Atlanta AG, Germany. De Weide Blik is active in the production, import, export, handling and logistics of fresh fruit, vegetables, flowers, flower bulbs, plants and convenience meals. Atlanta is active in the import, export, packing, handling and logistics of fresh fruit and vegetables and banana-ripening services (OJ C 178/25, 15.07.2008).

2. **Gefa/Pema** – Proposed acquisition by GEFA Gesellschaft für Absatzfinanzierung mbH (‘GEFA’), Germany, belonging to the Société Générale banking group (‘SG’), France, of PEMA GmbH (‘PEMA’), Germany. SG and GA are active in financing solutions for mobile investment goods, inter alia trucks and trailers. PEMA is active in the renting of trucks and trailers and corresponding services (OJ C 178/27, 15.07.2008).

3. **CASC JV** – Proposed acquisition by Cegedel Net SA (‘Cegedel Net’), Luxembourg, ELIA System Operator SA/NV (‘ELIA’), Belgium, EnBW Transportnetze AG (‘EnBW TNG’, Germany), E.ON Netz GmbH (‘ENE’), Germany, RTE EDF Transport SA (‘RTE’, France), RWE Transportnetz Strom GmbH (‘RWE TSO’), Germany, and Tennet TSO BV (‘Tennet TSO’), the Netherlands, of joint control of the newly established Capacity Allocation Service Company for Central Western Europe (‘CASC-CWE’). Each of these undertakings is active in the operation of electricity transmission systems. CASC-CWE will implement and operate services related to the allocation of power transmission capacities on the common borders between Belgium, France, Germany, Luxembourg and the Netherlands (OJ C 180/24, 17.07.2008).

4. **Simplified procedure cases**
   - **Burani/3i/APB** (OJ C 178/26, 15.07.2008).
   - **Triton/Altor/Papyrus Group** (OJ C 180/26, 17.07.2008).

Phase I Clearances
5. **Clearances with undertakings**
   - **Lesaffre/GBI UK** – The European Commission has approved the proposed acquisition of GBI UK (GB Ingredients Ltd and BFP Wholesale Ltd), engaged in the yeast business and owned by Gilde B.V, by the French yeast manufacturer Compagnie des Levures Lesaffre. The Commission’s decision is conditional upon Lesaffre’s commitment to divest GBI’s yeast production facility in Felixstowe, UK (IP/08/1135, 11.07.2008).
   - **Nordic Capital/ConvaTec** – The European Commission has conditionally approved the proposed acquisition of ConvaTec of the US by Nordic Capital of Jersey, the Channel Islands. The Commission’s decision is conditional upon the commitment by Nordic Capital to divest its entire wound care business as well as its ophthalmic needles business, both located at the Redditch site (IP/08/1146, 16.07.2008).
6. **Unconditional clearances**

> **Berkshire Hathaway and Munich Re/GAUM** (IP/08/1139, 15.07.2008).

> **Strabag/Kirchhoff** (IP/08/1145, 16.07.2008).

> **Danisco/Abitec** (IP/08/1147, 17.07.2008).

7. **Unconditional clearances: simplified procedure**

> **Shell/BP/AFS/Globefuel** (MEX/08/0714, 14.07.2008).

> **DuPont/Danisco/DDCE** (MEX/08/0714, 14.07.2008).

> **Investor/Altor/Lindorff** (MEX/08/0717, 17.07.2008).

### Antitrust

8. **Commission finds that CISAC’s EEA members have infringed Article 81** – The European Commission announced that it has found that membership and territoriality clauses contained in reciprocal representation contracts between collecting society EEA members of the International Confederation of Societies of Authors and Composers (CISAC) infringe Article 81(1) of the EC Treaty (IP/08/1165, 16.07.2008 and MEMO/08/511, 16.07.2008).

9. **Commission sends further statement of objections to Intel** – The European Commission announced that it has sent a supplementary statement of objections to Intel reinforcing its allegations that Intel has breached Article 82 of the EC Treaty by acting in a manner designed to exclude its main rival, AMD, from the x86 Computer Processing Units (CPU) market (MEMO/08/517, 17.07.2008).