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A legal update from Dechert's Antitrust Group

Nervous Neelie? Court Orders EU Commission to Pay Damages for Wrongly Blocking Merger

Key Points for Clients to Consider

- This is the first time the Court of First Instance has ordered the Commission to pay damages for wrongly prohibiting a merger.
- Although the Commission's substantive analysis was not at stake here, its blatant disregard of the parties' basic procedural rights in this case was considered to be unlawful and sufficient to trigger its liability.
- The Commission's liability in the merger area will act as a welcome additional "check and balance" on its powers.
- The Commission is likely to take this lesson to heart and act cautiously in its review of future mergers.
- As the Commission strives to make sure it gets its merger appraisals right, leaving no stone unturned in the process, notifying parties are likely to face increasingly burdensome in-depth investigations of their mergers.

A judgment issued by the European Court of First Instance on July 11, 2007, is likely to make Neelie Kroes, the EU Commissioner for Competition, and her staff much more cautious in their approach to merger filings. From now on, the Commission must be prepared to be sued for damages if it makes serious errors in the way in which it handles these cases, and this is likely to make the merger process more arduous for notifying parties, as the Commission 'tightens' its review process.

The European Court of First Instance has ordered the Commission to pay damages to Schneider Electric SA, a French industrial group, because of the Commission's (mis)handling of Schneider's merger with another French industrial group, Legrand, which caused the company to suffer financial losses. Having notified its acquisition of Legrand to the Commission, Schneider was ultimately forced to divest this business at a reduced price, due to the way in which the Commission dealt with the appraisal process. This is the first time that the Commission has been ordered to pay damages to a company because of errors made during the processing of a merger notification.

Background

In **February 2001**, Schneider notified the Commission of its intention to acquire Legrand. This merger would have created one of the world's largest electrical companies. The acquisition was

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to take place as a public exchange offer for shares. EU merger filings are normally suspensive and prevent a transaction from being implemented until the Commission has approved it, but in this case, Schneider obtained a derogation from the rule in order to comply with stock exchange regulations. According to this derogation, Schneider was allowed to acquire the shares in Legrand, but not to vote them or exercise control until the Commission had completed its merger review process.

In **October 2001**, subsequent to the close of the public offer and the acquisition by Schneider of 98% of the shares in Legrand, the Commission declared the merger to be incompatible with the common market. As a result, it ordered Schneider to divest itself of its interests in Legrand.

Schneider immediately appealed to the Court of First Instance against this decision (under a so-called expedited process which, nonetheless, took a year to be completed). As a safeguard, it negotiated a contract of divestiture with the consortium Wendel/KKR, which would purchase the shares in Legrand at a discounted price if Schneider's appeal failed.

In **October 2002**, the Court of First Instance overturned the Commission's prohibition decision. It found that the Commission had disregarded Schneider's rights of defence by prohibiting the merger based on objections which Schneider was not aware of until the publication of the final prohibition decision. Schneider had been given no opportunity to challenge the Commission's objections or to offer remedies to redress them. The court decided that the Commission's decision was severely flawed by this blatant disregard for Schneider's basic rights of defence and instructed the Commission to re-evaluate the merger.

The Commission began this re-evaluation the day after the court overturned its decision. However, in the face of the Commission's persistent doubts about the prospects for the merger, Schneider decided the safest course was to sell Legrand, and it sold the company to the consortium pursuant to the contract of divestiture. Schneider claims that it suffered losses of €1.6 billion, because it had to sell Legrand at a considerably lower price than that for which it originally acquired the company, and due to costs associated with the long-running merger review. With nothing more to lose, Schneider appealed to be compensated for its losses on the basis that the losses occurred as a result of the Commission's illegal prohibition decision.

Judgment of July 11, 2007

In this most recent case, the Court of First Instance, responding to Schneider's appeal for compensation, has confirmed that Schneider should be compensated for some of the financial losses it incurred as a result of the Commission illegally prohibiting the merger. The actual amounts to be awarded will be assessed by an expert at a later date, but the court has decided firmly on the principle that Schneider should be compensated for two separate sources of financial loss.

The first of these are the costs which Schneider incurred in having to face a second appraisal for its acquisition of Legrand, including legal and administrative fees. The court confirmed that a second source of financial loss arises from the reduced divestiture price for Legrand that Schneider was forced by circumstances to negotiate. However, the Commission will only be required to compensate Schneider for two-thirds of the losses from this second source. The court recognizes that Schneider voluntarily took on the risk, which is inherent to this process, that its acquisition of Legrand would be prohibited. Consequently, it is not entitled to compensation for 100% of the loss caused by having to sell its shares in Legrand.

The Commission will no doubt be pondering whether it should appeal this judgment to the European Court of Justice, the supreme appellate body at the European level, which hears appeals to points of law only. Whatever course of action it decides to take, there can be no doubt that the Commission will take this lesson to heart and clean up its procedures.

Implications for Ongoing and Future Mergers

EU merger filings are already time consuming and expensive undertakings which involve, *inter alia* for notifying parties, the drafting of a very burdensome notification form, onerous data collection exercises, and a continuous significant contribution to the Commission's substantive analysis in the form of detailed legal submissions on the effects of the merger on competition. This new case is likely to make things worse. The Commission has had its knuckles rapped by the Court of First Instance, firstly by having its prohibition decision overturned back in 2002, and secondly by having damages awarded against it in this current case. It will not want to become embroiled in similarly embarrassing cases in the future. Just as the

burden on the Commission to "get things right" will increase, by domino effect, the burden on the parties in the EU merger notification process can also be expected to become more demanding. Investigations are likely to become increasingly exacting and more drawn out, as the Commission seeks to avoid future costly consequences of not doing its job properly.

As the EU merger notification process becomes more onerous for all involved, it is possible that the Commission will attempt to pass on increased costs to notifying companies. Currently, the EU does not charge filing fees for submitting merger notifications. National antitrust authorities across the EU do charge fees. The Commission may well decide that notifying parties should make contributions to the costs of increasingly expensive investigations and introduce filing fees itself.

Possibility of Future Claims

This case will likely not open the floodgates to future claims for compensation against the Commission. The Court of First Instance was keen to stress that the Commission only incurred this liability because of its high degree of fault in denying Schneider its basic right to defence during the merger review process. The court did not impose damages for any substantive deficiencies in the Commission's analysis of the merger. If damages are to be awarded in the future, it must be shown that, as in this case, the Commission exhibited a grave and manifest disregard for the limits of its powers. In practice, this case is unlikely to herald a new culture of compensation in the EU. This, however, will come as little solace to Competition Commissioner Kroes and her colleagues as they increasingly feel under fire from the Court of First Instance.

Between a Rock and a Hard Place

Commissioner Kroes now finds herself in an unenviable position. The Commission must tread carefully when prohibiting mergers, but in practice the unique circumstances of the Schneider case will not arise frequently. Since 1990, almost 3,500 merger notifications have been made with the EU, and only 20 of these have been prohibited. It is noteworthy that the Commission also faces challenges to mergers that it approves. It is currently reassessing the Sony/BMG joint venture which it approved in July 2004, an approval which was overturned by the Court of First Instance in July 2006 as a result of a challenge brought by third-party competitors. The Schneider decision opens up the possibility of damages being awarded in cases such as this, where the Commission's decision to allow a merger to proceed causes third parties to suffer loss. There is no doubt that the Commission is becoming increasingly accountable.

Checks and Balances: The Power of the Commission

The Commission is regularly accused of being a law unto itself: insufficiently restrained by the checks and balances that are considered key to the preservation of the rule of law in other jurisdictions. The charge is that the Commission is not only policeman and prosecutor in European antitrust cases, but judge, jury, and executioner as well. This case should go some way to allaying fears that the Commission is insufficiently supervised and free to act as it pleases. The Court of First Instance has confirmed that it will not ignore instances of the Commission overstepping the limits of its powers and that it is willing to invoke the liability of the Commission for losses it causes.

Legacy of the Schneider Case

When the Court of First Instance first dealt with the Schneider merger and overturned the Commission's original prohibition in October 2002, it was one of a number of merger cases in which it found the Commission to have wrongly prohibited a merger and that highlighted clear deficiencies in the Commission's merger review process. In the wake of these cases, a raft of procedural safeguards were adopted which, it was hoped, would introduce new checks and balances into the system.

It may well be that this most recent installment in the Schneider saga will again act as a catalyst, improving the way in which the Commission deals with mergers. Increasingly exacting and in-depth merger investigations may inconvenience companies notifying mergers in the EU, but if they ensure that the Commission tries harder to be more accurate in its decision making, they should be welcomed with open arms.

Practice group contacts

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