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A legal update from Dechert's Antitrust Group

Senior EU Court Judgement Brings Music to Sony BMG's Ears

On 10 July 2008, the European Union's most senior court, the European Court of Justice (ECJ), delivered a significant Judgement endorsing the joint venture between Bertelsmann AG and Sony Corporation of America. The points addressed by the ECJ in its Judgement deliver some fine-tuning to merger notification review.

Key Points for Clients to Consider

- Statements of Objections are provisional documents which the Commission may amend and depart from
- Same standard and burden of proof will be applied to merger clearance and merger prohibition decisions
- Where merger applications face objections on the grounds of post-merger tacit coordination, applicants should request further information on the Commission's views on how competitors would make such arrangements so these fears can be addressed
- Commission victory may reveal a more rigorous and active Commission in the coming months, which imposes greater demands for information and evidence on applicants and which issues a greater number of Statements of Objections

A Complex Legal and Procedural Saga

On 9 January 2004, Bertelsmann and Sony notified the European Commission of their intention to merge their global recorded music businesses to form the joint venture known today as Sony BMG. It was predictable that the notification would attract some review before a decision was made on clearance. However, what actually unfolded over the course of the past four years was not only a Commission review but a monumental saga riddled with both legal and procedural complexities which this month reached the highest echelons of the European courts.

Following an in-depth (so-called "Phase II") investigation into the proposed merger, the Commission in July 2004 unconditionally approved the Sony BMG joint venture. In January 2005, however, the rare act of a third party action against the Commission decision cast doubts over the future of the merger. The action was brought by Impala, an association of independent music producers. Impala disagreed with Commission findings and argued that the Commission should not have approved the merger as it had manifestly erred in assessing the existing market and the impact of the merger.

In 2006, Impala's action resulted in the junior European court, the European Court of First Instance (CFI), annulling the Commission's decision to approve the merger. The CFI found the Commission's decision was vitiated by

manifest errors of assessment and was inadequately reasoned.[1] The CFI judgement, in turn, led Bertelsmann and Sony to launch an appeal of their own against the CFI decision with the ECJ later the same year. They argued that the CFI had erred in law on several different counts.

This action has culminated now, four years after the original Commission decision approving the merger, in the ECJ endorsing the merger and setting aside the CFI's decision to annul it. Showing both junior and senior courts to be singing from different hymn sheets, the ECJ found the CFI had committed errors of law in annulling the Commission decision to approve the merger.

Role of Statement of Objections Crystallised

A Statement of Objections is a written document issued by the Commission to merger applicants to inform them of the Commission's preliminary findings following the initiation of a Phase II in-depth investigation and of the objections against the merger and to give applicants an opportunity to respond.

In overturning the Commission decision, the CFI relied heavily on the Statement of Objections issued by the Commission during its investigation. In particular, the CFI was critical of the fact that the Commission's final decision showed a marked "U-turn" from the conclusions drawn in the Statement of Objections.

Deciding the CFI had erred in law by treating certain conclusions set out in the Statement of Objections as established, the ECJ confirmed that:

- The Statement of Objections is only a **provisional** document (procedural and preparatory in nature);
- The Statement of Objections does not bind the Commission to stick to the views (including factual and legal assessments) set out in the statement;
- The Commission is not obliged to justify any subsequent departures it makes from the Statement of Objections in its final decision; and
- The Statement of Objections may be amended by the Commission in further assessments following observations submitted by the interested parties.

Sanctity of Merger Applicants' Rights of Defence Re-Affirmed

The ECJ also re-affirmed the importance of giving merger applicants an opportunity to present their defence, which is a fundamental principle of Community law. In this regard, the ECJ held:

- Notifying parties should not be criticised for putting forward particularly decisive arguments, facts or evidence only in response to a Statement of Objections;
- Arguments and evidence submitted by the applicants in response to the Statement of Objections should not be subject to different and more stringent standards regarding their probative value;
- The Commission's final decision must "disclose in a clear and unequivocal fashion the reasoning followed" and this must be sufficient to allow relevant parties to establish the reasons for a particular measure and to allow the courts to conduct their reviews; and
- The CFI was wrong to rely on confidential documents provided by Impala as a basis for annulment. The documents had not been disclosed in sufficient time to enable Bertelsmann and Sony to digest and respond to the arguments Impala was asserting on the basis of those documents.

Merger Prohibition and Merger Clearance Burden of Proof Harmonised

The ECJ rejected the argument put forth by the merger applicants of a general presumption in favour of notified concentrations being compatible

[1] Separately, the CFI annulment of the Commission's earlier merger approval decision led Bertelsmann and Sony to submit a new notification to the Commission for the same transaction. The Commission, in turn, considered the re-notified transaction in light of then current market conditions in 2007. Later the same year, following a further Phase II investigation, the Commission unconditionally approved the merger again. The merger is therefore completed, but in true "refusal to let the music stop fashion", Impala has challenged the Commission's second approval decision. The outcome of Impala's second action at CFI level also remains to be seen.

with the common market. The court disagreed that merger prohibitions should be subject to a higher standard of proof because they involve a limitation on applicants' commercial freedom. Clarifying that there was nothing in the EC Merger Regulation about applying different standards of proof to merger decisions versus clearance decisions, the senior court concluded that clearance decisions must be subject to the same rigorous standard and burden of proof that is applied to merger prohibitions.

Guidance on Test for Establishing Collective Dominance through Tacit Coordination

One of the major risks to competition which the Commission considered during its investigations in this case was the threat of collective dominance, whereby the merged entity and the remaining three major players in the recorded music business industry might dominate the market in a collusive and anti-competitive way. Indeed, in its Statement of Objections, the Commission found market conditions could be susceptible to such collusion through implicit understandings between the major players. However, following the facts and evidence supplied by the merger applicants in response to the Statement of Objections, the Commission was satisfied that the market was not sufficiently transparent to be vulnerable to such tacit coordination, especially in light of each major player's different discounting strategies, making them difficult to monitor. Conversely, however, the CFI was not so satisfied and found the Commission had erred by, inter alia, failing to provide sufficient reasoning to explain its conclusions regarding market transparency.

The ECJ, on the other hand, concluded that the CFI had misinterpreted the legal test it should have applied when finding a position of collective dominance was likely to arise through tacit arrangements between the merged entity and the remaining major record companies. The ECJ provided some useful guidance on this point:

- The criteria for establishing collective dominance as set out in the *Airtours/First Choice*[2] case should not be applied in a mechanical, "check the box" fashion. It is not sufficient to merely find that the criteria exist.

Airtours/First Choice Conditions for Collective Dominance

The following points must be established:

- **Market Transparency**: each competitor in a dominant oligopoly is able to know and monitor the other members to ensure they are all adopting uniform policies
- **Longevity:** mechanisms are in place to deter members from departing from the policies
- **Solidity**: adopted policies can withstand challenges from other (present/future) competitors and from customers

- A plausible concept of how the tacit coordination could work in practice must be established by the Commission, examining in particular in what anti-competitive way(s) the parties might coordinate, and the *Airtours/First Choice* criteria must then be applied to this theory to obtain an overall picture of the coordination.

Implications for Future Commission Decisions

The Commission has not always fared well in merger decisions that have reached the courts. In particular, in 2002 the Commission's merger prohibition decisions in *Airtours/First Choice*, *Schneider/Legrand*[3] and *Tetra Laval/Sidel*[4] were all overturned by the European courts. In 2007, the Commission was dealt a further blow emanating from the *Schneider/Legrand*[5] case when it was ordered to pay compensation for its prohibition of a merger which the European courts had deemed to be valid.

Perhaps unsurprisingly, the repercussions have reverberated in the Commission's approach to merger review since then. Woeful of allowing itself to attract further damages claims or any further battering from the European courts, the Commission has in recent cases been reluctant to

2 Case T – 342/99 *Airtours v Commission* [2002] ECR II – 2585

3 Case T-310/01 *Schneider Electric v Commission SA* [2002] ECR II-4071

4 Case T-5/02 *Tetra Laval BV v Commission* [2002] ECR II-4381

5 Case T-351/03 - Schneider *Electric SA v Commission*; "Nervous Neelie? Court Orders EU Commission to Pay Damages for Wrongly Blocking Merger", *Dechert OnPoint*, Issue 21 (July 2007), available at: http://www.dechert.com/library/Antitrust_21_07-07_Court_Orders_EU_Commission_to_Pay_Damages.pdf

issue Statements of Objections and has often not proceeded with a full Phase II investigation.

The Commission has been using various tactics to mask this practice, from extending Phase I initial investigations through "stop-the-clock" mechanisms to aborting Phase II investigations short of reaching the point of needing to issue a Statement of Objections. In addition, it has been delaying complex merger reviews to try to build sound and impregnable cases. The senior European court's approval of the Sony BMG merger, a decision in which the Commission refused to change the record in spite of all the criticism levelled against its decision-making and application of law is a welcome life line for which the Commission has been hoping and is a victory the Commission will be keen to uphold. For merger applicants, this could herald an era of an even more demanding Commission. The Commission will be under pressure to ensure that its decisions are always supported by adequate evidence and reasoning. Some implications that might follow from this change in tempo:

- A potential increase in the number of Statements of Objection that are now issued; and
- Demands from the Commission for information and evidence from applicants may become more taxing and cumbersome, as the Commission will be seeking to build an unequivocal case.

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/antitrust.

Jeffrey W. Brennan
Washington, D.C.
+1 202 261 3326
jeffrey.brennan@dechert.com

Stephen D. Brown
Philadelphia
+1 215 994 2240
stephen.brown@dechert.com

Peter R. Crockford
London
+44 20 7775 7506
peter.crockford@dechert.com

Paul T. Denis
Washington, D.C.
+1 202 261 3430
paul.denis@dechert.com

Rebecca P. Dick
Washington, D.C.
+1 202 261 3432
rebecca.dick@dechert.com

H. Joseph Escher III
San Francisco
+1 415 262 4545
h.joseph.escher@dechert.com

Michael D. Farber
Washington, D.C.
+1 202 261 3438
michael.farber@dechert.com

Carolyn H. Feeney
Philadelphia
+1 215 994 2247
carolyn.feeney@dechert.com

James A. Fishkin
Washington, D.C.
+1 202 261 3421
james.fishkin@dechert.com

Paul H. Friedman
Washington, D.C.
+1 202 261 3398
paul.friedman@dechert.com

George G. Gordon
Philadelphia
+1 215 994 2382
george.gordon@dechert.com

Robert C. Heim
Philadelphia
+1 215 994 2570
robert.heim@dechert.com

Kevin T. Kerns
Philadelphia
+1 215 994 2729
kevin.kerns@dechert.com

Edward L. Kling
London
+44 20 7184 7612
edward.kling@dechert.com

Christine C. Levin
Philadelphia
+1 215 994 2421
christine.levin@dechert.com

Pierre-Manuel Louis
Brussels
+32 2 535 5479
pierre.louis@dechert.com

Isabelle M. Rahman
Brussels
+32 2 535 5445
isabelle.rahman@dechert.com

Will Sachse
Philadelphia
+1 215 994 2496
will.sachse@dechert.com

Stephen A. Stack, Jr.
Philadelphia
+1 215 994 2660
stephen.stack@dechert.com

Joseph A. Tate
Philadelphia
+1 215 994 2350
joseph.tate@dechert.com

www.dechert.com