Legal Backgrounder

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CLOSER JUDICIAL SCRUTINY WILL ALTER ANTITRUST REVIEW OF MERGERS IN EUROPE

by

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Earlier this year, the Court of Justice of the European Communities ("the ECJ") handed the European Commission another stinging defeat when it dismissed the Commission's appeal of the 2002 decision of the Court of First Instance ("CFI") in Case T-5/02, *Tetra Laval v. Commission* [2002] ECR II-4381.[1] This is the fifth loss suffered by the Commission recently.[2] Combined, these losses have forced the European Commission to re-evaluate its merger enforcement policies. This will undoubtedly force the Commission to make significant changes. First and foremost, the Commission will have to review the arguments advanced by the merging parties with less suspicion while analyzing with greater skepticism the arguments made by the merging parties' rivals, who often attempt to tilt the merger review process to their own advantage. Unless it makes fundamental changes, the Commission's decisions will not survive judicial review and its losing streak will continue unabated.

Second, to survive judicial review of cases involving conglomerate mergers, the Commission will have to re-assess its views about these combinations. It certainly will have to take into account that its apparent hostility toward conglomerate mergers appears to be out of step with how the Community's courts view them. Both the ECJ and the CFI emphasized in their respective *Tetra Laval* decisions that conglomerate mergers generally pose less risk of competitive harm than horizontal and vertical mergers. Yet the Commission has subjected these transactions to intense scrutiny and occasionally harsh treatment — scrutiny and treatment that seem wildly disproportionate to the risk of competitive harm actually posed by such mergers. The Commission thus will have to moderate its attitude toward them or, at the very least, be far more discriminating about which of these mergers to reject.

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[1]Case C-12/03 P *Commission v. Tetra Laval* [2005] (Feb. 15, 2005) (available at http://tinyurl.com/6xakt).

[2]*See* Case T-310/00 *MCI v. Commission* [2004] (Sept. 28, 2004) (available at http://tinyurl.com/6xakt); Case T-342/99 *Airtours plc v. Commission* [2002] ECR II-2585; Case T-310/01 *Schneider Electric v. Commission* [2002] ECR-II 4071; Case T-5/02 *Tetra Laval v. Commission*, [2002] ECR II-4381.

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Finally, the Commission will have to reconsider what can only be characterized as its disdain for behavioral remedies. The ECJ and the CFI both rejected the Commission's *Tetra Laval* decision in part due to its rejection "on principle" of Tetra's offer to make certain behavioral commitments. The Commission rejected Tetra's offer due to its long-standing preference for structural remedies. However, as the Community courts implicitly acknowledged, structural remedies can be inappropriate in close cases — those in which government intervention can do more harm than good by discouraging efficiency-enhancing mergers that pose either little or speculative risk of anti-competitive harm. The Commission therefore will have to adopt a more flexible attitude toward remedies in the future.

Background. On October 30, 2001, the European Commission prohibited the proposed merger of Sidel SA and Tetra Laval BV.[3] At the time, Sidel manufactured stretch blow molding machines, which are used during the process of packaging liquid foods in plastic, while Tetra held a dominant position in the adjacent carton-packaging market through a related company. Although conglomerate mergers such as this one are in general competitively neutral, the European Commission concluded that the transaction would encourage Tetra to "leverage" its dominant position in the carton-packaging market to persuade customers who might use plastic packaging to buy Sidel's machines, thereby foreclosing smaller competitors from the market for those machines. The parties offered to ameliorate the Commission's concerns by proposing to enter into certain binding commitments that would preclude the merged entity from engaging in such anticompetitive conduct. The Commission refused to consider those commitments "on principle," expressing its preference for structural remedies. It later ordered Tetra to divest itself of its Sidel shares.[4]

Tetra appealed, seeking annulment of the Commission's decisions. The CFI granted Tetra's application for annulment on October 25, 2002.[5] It held that the Commission made erroneous findings of fact in connection with its analysis of the relevant product markets; that the Commission failed to produce "convincing evidence" that the proposed conglomerate merger would create or strengthen a dominant position within a foreseeable period; that the Commission erred by refusing to consider how the illegality of leveraging would affect the merged entity's incentive to engage in such conduct, and the likelihood of detection and punishment by competition authorities at both the Community and national level; and, last, that the Commission erroneously refused to take into account the commitments that the parties offered to make to ameliorate the Commission's concerns. Although the Commission subsequently re-evaluated the proposed transaction and permitted the parties to consummate it,[6] it asked the ECJ to review the CFI's decision.

The Decision. In a decision issued on February 15, 2005, the ECJ dismissed the European Commission's appeal. With only one exception, the ECJ found no errors in the lower court's decision. The ECJ held that the CFI's reference to "convincing evidence" was not, as the

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[3]Commission Decision 2004/124/EC, *Tetra Laval/Sidel*, 2004 O.J. (L 43) 13.

[4]Commission Decision 2004/103/EC, *Tetra Laval/Sidel*, 2004 O.J. (L 38) 1.

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

[6]Commission Decision Case No. COMP/M.2416 *Tetra Laval* (Jan. 13, 2003).

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Commission contended, an attempt by the CFI to impose a higher standard of proof on the Commission. Rather, it was simply a statement designed to draw "attention to the essential function of evidence, which is to establish convincingly the merits of an argument or, as in the present case, of a decision on a merger."[7] The ECJ further held that the proper analysis of a conglomerate merger required the Commission to consider that any anti-competitive effects might not occur for "a lengthy period of time in the future" and that "the leveraging necessary to give rise to a significant impediment to effective competition means that the chains of cause and effect are dimly discernible, uncertain and difficult to establish."[8] Consequently, to disallow a conglomerate merger, the Commission had to produce evidence of sufficient "quality" to "support the Commission's conclusion."[9]

The ECJ then rejected the Commission's claim that the CFI should have been more deferential to the Commission's factual findings. That the Commission enjoys discretion in economic matters does not mean that the Community Courts must blindly defer to the Commission, ruled the ECJ. The ECJ held that the Community Courts must ensure that the evidence relied upon by the Commission is "factually accurate, reliable and consistent," that it sufficiently takes into account the complexity of the situation, and that it is "capable of substantiating the conclusions drawn from it. Such a review is all the more necessary in the case of a prospective analysis required when examining a planned merger with conglomerate effect."[10] The ECJ went on to hold that the CFI's review of the Commission's decision, including its characterization of the Commission's conclusions as based on "insufficient, incomplete, insignificant and inconsistent evidence," complied with Community law.[11]

Next, the ECJ held that the CFI's analysis of whether the merged entity would have the incentive to engage in unlawful leveraging was flawed. The ECJ agreed that the analysis required by the CFI "would be too speculative and would not allow the Commission to base its assessment on all of the relevant facts with a view to establishing whether they support an economic scenario in which a development such as leveraging will occur."[12] The court nevertheless upheld the lower court's decision: By concluding that the Commission had erroneously refused to consider the behavioral commitments the merging parties proposed. The ECJ held that the Commission "had to take into account" Tetra's offered commitments "when assessing the likelihood that the merged entity would act in such a way as to make it possible to create a dominant position on one or more of the relevant markets."[13] The ECJ went on to remind the Commission that pursuant to Community law, "the categorisation of a proposed commitment as behavioural or structural is immaterial and

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[7]Case C-12/03 P *Commission v. Tetra Laval* [2005] (Feb. 15, 2005) at ¶ 41.

[8]*Id.* at ¶ 43.

[9]*Id.*

[10]*Id.* at ¶ 39.

[11]*Id.* at ¶ 48.

[12]*Id.* at ¶ 77.

[13]*Id.* at ¶ 85.

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that the possibility cannot automatically be ruled out that commitments which are prima facie behavioural, . . ., may also be capable of preventing the emergence or strengthening of a dominant position."[14] Finally, the ECJ summarily rejected the Commission's arguments regarding the CFI's assessment of the factual record, holding that review of CFI's factual assessment was beyond the scope of its review.[15]

Conclusion. This decision likely will cause the Commission to re-evaluate and revise its merger enforcement policies, particularly with respect to remedies and conglomerate mergers. As to the latter, the Commission will have to re-assess its policy of rejecting behavioral commitments "on principle" due to its preference for structural remedies. In holding that the Commission improperly refused to consider the behavioral remedy suggested by Tetra, the ECJ effectively reminded the Commission that structural remedies are drastic and should be applied only when necessary to redress the competitive harm that the proposed merger will cause. This does not necessarily mean that the Commission will be obligated to accept behavioral remedies in the future; rather, it means that the Commission will have to develop a much more flexible approach to remedies. That should be welcome news to the business community.

Additionally, the ECJ's decision could cause the Commission to shift its enforcement efforts away from conglomerate mergers. While the ECJ refused to hold that conglomerate mergers should be presumed lawful, the ECJ, like the CFI, was dubious of the Commission's leveraging theory largely because of its firm belief that conglomerate mergers generally do not pose a significant risk of anti-competitive harm. Having had its decision so soundly rejected by not one, but two courts might cause the Commission to view such mergers with less hostility and revise its merger enforcement policies accordingly.

Finally, and most importantly, this decision makes it patently obvious that neither the ECJ nor the CFI will blindly defer to the Commission in merger cases. The CFI has annulled four of the European Commission's recent merger decisions.[16] The ECJ's decision in this case thus represents the fifth major defeat suffered by the Commission's merger enforcement program since 2002. This decision, in addition to those that came before it, likely will force the Commission to be far more discriminating when exercising its prosecutorial discretion in merger cases. That is, to survive judicial scrutiny, the Commission will have to review the arguments proffered by merging parties in support of their transactions with more objectivity and subject those advanced by the merging parties' competitors to a far more critical analysis. Therefore, theoretically, the days when the Commission bars transactions based solely on speculative and what appear to be, on occasion, farfetched theories of liability should be gone, as should the days when competitors of merging firms can count on the Commission to bar transactions based on such theories.

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[14] *Id.* at ¶ 86.

[15] *Id.* at ¶ 143(CFI's assessment of the evidence "is not subject to review").

[16] *See* Case T-310/00 *MCI v. Commission* [2004] (Sept. 28, 2004) (available at http://tinyurl.com/6xakt); Case T-342/99 *Airtours plc v. Commission* [2002] ECR II-2585; Case T-310/01 *Schneider Electric v. Commission* [2002] ECR-II 4071; Case T-5/02 *Tetra Laval v. Commission*, [2002] ECR II-4381.

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