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The European Court of First Instance Annuls the European Commission's Decision Approving the SonyBMG Joint Venture

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On July 13, 2006, in IMPALA v. Commission, the European Court of First Instance (CFI) surprised nearly all observers by reversing the European Commission's 2004 decision that had approved the creation of the joint venture between Sony and Bertelsmann combining their recorded music businesses (SonyBMG). In a decision with implications well beyond the specific facts of this joint venture, this is the first time the CFI has reversed a Commission decision that had unconditionally authorized a transaction. The CFI's IMPALA decision

(i) broke new ground by potentially dismantling a joint venture that has been operating for two years;

(ii) asserts closer control by the European Courts over the Commission's decision-making;

(iii) further empowers third-party competitors in the EC merger review process, including now the judicial review of merger decisions; and

(iv) portends another GE/Honeywell-style debate between the European regime and the U.S. antitrust authorities, which had approved the SonyBMG joint venture in 2004 without the issuance of a Second Request.

While the CFI had annulled EC decisions blocking potential mergers in the past (in the Airtours, Schneider and Tetra Laval cases), here the CFI has reversed a clearance decision. In 2004, the EC approved the SonyBMG joint venture because it concluded that there was insufficient evidence that the four remaining major music companies could tacitly coordinate their pricing decisions through a "collective dominant position." The EC believed that the heavy discounting offered off list prices by the majors to key retailers created a market where prices lacked the price transparency necessary for such tacit coordination. Further, the EC held that the majors could not appropriately monitor and punish firms deviating from this tacit coordination, because the recorded music market lacked a "retaliatory" mechanism which would allow the majors to discipline deviations from coordination. The CFI reversed, and held, in sharp language, that the EC had relied on incomplete data and had failed to take account of all relevant data in reaching its conclusion as to pricing transparency, and suggested, further, that excluding a major from compilation albums could constitute a mechanism to retaliate against anyone that deviated from coordination.

REVERSING A CLEARANCE DECISION

By annulling the SonyBMG clearance decision, the CFI broke new ground and altered the degree of legal finality previously afforded to mergers approved by the European Commission. While the prior reversals in merger cases (Airtours, Schneider, and Tetra Laval) affected potential mergers that had been blocked by the Commission before they could be consummated (all were abandoned after the Commission blocked them), the CFI's ruling in IMPALA reverses the Commission's approval of

a joint venture. While an objecting third party pursued an appeal, the parties proceeded to consummate their transaction. The appeal itself took nearly two years. Under the EC merger regulation, merging parties cannot close a transaction until the European Commission approves the arrangement. While this principle remains, merging parties now also face the prospect of having to de-merge and disentangle themselves long after having received the Commission's approval.

Here, Sony and Bertelsmann will have to re-apply to the Commission to seek clearance, and the Commission will have to re-examine whether the joint venture restricts competition. This new assessment will be based on current market conditions, which have changed significantly in the recorded music business, especially with the emergence of the legal distribution of music in digital format, only a nascent development in 2004. It could take as long as a year for the Commission to rule again (the joint venture will be permitted to continue to operate in the interim). If the Commission, following the strictures of the new CFI decision, decides to block the joint venture, Sony and Bertelsmann will face the prospect of unwinding their joint venture more than three years after it began operations.

ROLE OF THE CFI IN MERGER CASES

To annul all, or part, of a Commission decision, the CFI needs to find that the Commission has made a "manifest error of assessment." In the past, the Community Courts have deferred to the expertise of the Commission, especially in the economic analyses that commonly are made in the course of a merger review, and have stated that it is not for the Courts to substitute their own judgments for those of the Commission. The CFI's deference to the Commission had already begun to erode during its review of the Airtours, Schneider and Tetra Laval decisions. In IMPALA, the CFI has limited this deference even further and made it plain that it will not hesitate to review the record *de novo* in assessing whether the Commission has committed manifest error.

In its lengthy analysis, the CFI engaged in a thorough, and at times highly critical review of the evidence relied upon by the Commission. The CFI gave virtually no deference to the Commission's merger control expertise, its knowledge of the music industry, its economic sophistication, or, importantly, to its first-hand review of the evidence during its merger review process.

Interestingly, the CFI also ignored the fact that the SonyBMG joint venture had received regulatory approval outside the EU. The Federal Trade Commission (and every other competition authority that asserted jurisdiction around the world) had also unconditionally approved the SonyBMG joint venture in 2004. The CFI held that these approvals were irrelevant for the purpose of its review.

ROLE OF THIRD PARTIES IN THE MERGER CONTROL PROCESS

The CFI's judgment also highlights the influence given to third parties in the EU merger control process. IMPALA (the "Independent Music Publisher and Labels Association") describes itself as a group of 2500 independent recorded music companies. IMPALA had complained about the joint venture and intervened in proceedings before the Commission in 2004. After the Commission cleared the transaction, IMPALA appealed the Commission's decision. In the U.S., third parties have no standing to appeal merger clearances and private actions challenging a merger are extremely rare and are virtually never successful.

Historically, the European Commission has given more weight to the complaints of competitors and other third parties than either the Department of Justice or the Federal Trade Commission. The CFI's ruling further empowers third parties who, in addition to intervening before the Commission, now have the incentive to carry on in the appellate process.

THE BURDEN OF PROOF IN MERGER CASES

This judgment also creates a new dynamic in merger cases since the CFI has placed a significantly heightened burden on the Commission when it approves transactions. In Airtours, Schneider and Tetra Laval, the CFI held that the Commission bears the burden of adducing "convincing evidence" that a transaction would "in all likelihood" restrict competition. Here, the CFI seems to impose the same burden on the Commission to decide that a transaction does not restrict competition.

While nearly all merger statutes start from the proposition that mergers are pro-competitive and lawful until the government sustains its burden of proof demonstrating that the transaction will lead to a restriction on output or higher prices, the CFI's decision can potentially be seen as eliminating this starting principle by placing on the Commission the burden to demonstrate that a merger is in fact lawful. Now, the Commission will have to rely on "all relevant data" to approve a proposed merger. To meet this burden, it is likely that the Commission will have to request more extensive data from merging parties and third parties and rely less on data and arguments formulated by the parties to the transaction itself. It also may make it less likely that the Commission will approve competitively sensitive transactions in Phase I.

For further information about the implications of this decision, please feel free to contact members of the Firm's Antitrust Practice Group, including:

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