

# The Standard of Proof in EC Merger Control

Conclusions from the Sony BMG Saga

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## ABSTRACT

One of the most important developments in EC competition policy during 2006 was the Court of First Instance's (CFI) *Impala v. Commission* judgment annulling the European Commission's approval of the merger between the music units of Sony and Bertelsmann. It harshly criticized the Commission's Decision because it found that the evidence relied on was not capable of substantiating the conclusion. This was the first time that a merger decision was annulled for not meeting the requisite legal standard for *authorizing* the merger. Consequently, the CFI raised fundamental questions about the standard of proof incumbent on the Commission in its merger review procedures. On July 10, 2008, the European Court of Justice overturned *Impala*, yet it did not resolve the fundamental question underlying the judicial review of the Sony BMG Decision; does the Commission have the necessary resources and expertise to meet the Community Court's standard of proof? This paper addresses the wider implications of the Sony BMG saga for the Commission's future handling of complex merger investigations. It argues that the Commission may have set itself an impossible precedent in the second approval of the merger. While the Commission has made a substantial attempt to meet the high standard of proof imposed by the Community Courts, it is doubtful that it will be able to jump the fence again in a similar fashion under normal procedural circumstances.

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## 1 INTRODUCTION

One of the most important developments in EC competition policy during 2006 was the Court of First Instance's (hereafter: 'CFI') annulment of the European Commission's (hereafter: 'Commission') Decision authorizing the creation of Sony BMG, a joint venture incorporating the worldwide<sup>1</sup> recorded music businesses of Sony and Bertelsmann. In 2004, the Commission had concluded that the merger would not create or strengthen a collective dominance position on the part of the majors (i.e. Universal, Sony BMG, Warner, and EMI).<sup>2</sup> In *Impala v. Commission* (hereafter: '*Impala I*'), however, the CFI harshly criticized the Commission's Decision because it found that the evidence relied on by the Commission was not capable of substantiating that conclusion.<sup>3</sup> In doing so, the CFI raised fundamental questions about the standard of proof incumbent on the Commission in its merger review procedures. Two years later - after the Commission's reexamination of the concentration and even after the European Court of Justice's (hereafter: 'ECJ') judgment overturning *Impala I* - some of these questions linger on. The fact that the joint venture has now been brought to an end by Sony's acquisition of the 50% share of Bertelsmann<sup>4</sup> does not change this. As this paper will demonstrate, the implications of the Sony BMG saga indeed go far beyond the facts of this particular case.

The Commission's 2004 Sony BMG Decision should be seen in light of the CFI's consecutive annulment of three merger prohibition decisions in 2002: *Airtours v Commission* (hereafter: '*Airtours*'),<sup>5</sup> *Schneider Electric v Commission*<sup>6</sup> and *Tetra Laval v Commission* (hereafter: '*Tetra Laval I*').<sup>7</sup> The resoluteness by which the CFI criticized the Commission for its analysis of the evidence and questioned the rigor of its decisions in these judgments was unprecedented. The three CFI judgments, which were delivered over a five-month period, gave rise to a flood of criticism of the Commission's merger analysis and opened a debate about the economic soundness of its decisions.<sup>8</sup> Moreover, the judgments acted as a catalyst for a far-reaching reform of EC merger control, as the Commissioner for Competition (Mario Monti at that time) acknowledged that the judgments exposed significant errors:

“I believe that, in a certain time, with more hindsight, we will say that these judgments, no matter how painful, came at the right time. Indeed, there are no doubt lessons to be drawn from the judgments: in particular, it is clear that the CFI is now holding us to a very high standard of proof, and this has clear implications for the way in which we conduct our investigations and draft our decisions.”<sup>9</sup>

The detailed economic analysis that was undertaken by the Commission in the Sony BMG investigation should have been characteristic of the more central role given to economics

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<sup>1</sup> Except for Japan.

<sup>2</sup> Commission Decision COMP/M.3333 on *Sony/BMG* 2004.

<sup>3</sup> Court of First Instance, *Independent Music Publishers and Labels Association v Commission*, Case T-464/04 (hereafter: *Impala I*).

<sup>4</sup> Commission Press Release, 2008.

<sup>5</sup> Court of First Instance, *Airtours v Commission*, Case T-342/99.

<sup>6</sup> Court of First Instance, *Schneider Electric v Commission*, Case T-310/01.

<sup>7</sup> Court of First Instance, *Tetra Laval v Commission*, Case T-5/02 (hereafter: *Tetra Laval I*).

<sup>8</sup> Diaz 2004, 177-99.

<sup>9</sup> Monti 2002.

as a consequence of the merger control reform.<sup>10</sup> The increased emphasis on economic analysis in merger investigations has been a steady process that is continuing today. It was emphasized, for instance, by the appointment in 2003 of a Chief Competition Economist and an accompanying team of 10 specialized economists. The Sony BMG case was in fact the first case in which the economic guidance and the methodological assistance of the Chief Competition Economist were sought - in light of this the harsh criticisms of the CFI were particularly painful. The 2004 Sony BMG Decision should furthermore be seen as an attempt to comply with the strong felt standard of proof now imposed on the Commission by the Community Courts. Indeed, while the Commission expressed concerns about the high degree of concentration in the music industry, it concluded that the evidence available was not sufficiently strong to prove collective dominance and it thus approved the merger. The fact that the Decision was annulled for not meeting the requisite legal standard for *authorizing* a merger, is therefore both ironic and challenging because it put the Commission on a knife-edge.

Following an in-depth reassessment of the Sony BMG joint venture, the Commission again concluded in October 2007 that the transaction would not create or strengthen a dominant or collectively dominant position in the music markets in the European Economic Area (hereafter: 'EEA').<sup>11</sup> It struck back with what Competition Commissioner Neelie Kroes called "*one of the most thorough analyses of complex information ever undertaken by the Commission in a merger procedure*".<sup>12</sup> In parallel to this reinvestigation Sony and Bertelsmann had brought an appeal against *Impala I* to the ECJ. On July 10, 2008, the ECJ gave its judgment in *Bertelsmann and Sony Corp of America v. Impala* (hereafter: '*Impala II*'). It overturned *Impala I* because of a number of identified errors of law and referred the case back to the CFI. In the meantime, *Impala* - an international trade association of independent music companies - also appealed the Commission's second clearance Decision.<sup>13</sup> The Sony BMG saga thus continues.

While the ECJ did not give final judgment in the matter, it did address several matters of evidence and proof. These clarifications have to be welcomed, as they provide much-needed guidance on some of the issues that were raised by *Impala I*. However, they certainly do not resolve the fundamental question underlying the judicial review of the Sony BMG Decisions, namely whether the Commission actually has the necessary resources and expertise to meet the Community Courts' standards. Particularly in the communications sector this is a pertinent issue as the Commission is faced here with peculiar difficulties. Firstly, there is an accelerating change of markets due to the technological and market-led convergence. This is also true for the music industry where strategic alliances have been sought to benefit from the opportunities of a converging market (e.g. the delivery of digital music services via internet and mobile networks). Secondly, market investigations are complicated by the fact that communications have an essential role in our information-driven society both in terms of economic development of the sector and in its broader public interest.<sup>14</sup> Concentration tendencies in the music industry thus inherently also raise concerns about cultural diversity - something that is not easily translated in econometric analysis. The aim of this working paper is to address these broader issues by analyzing and evaluating the wider implications of both *Impala I* and *Impala II* for the Commission's future handling of complex merger investigations.

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<sup>10</sup> Aigner, Budzinski and Christiansen 2006, 2; Baxter and Dethmers 2006, 151-2; Levy 2005, 123-5.

<sup>11</sup> Commission Decision COMP/M.3333 on *Sony/BMG* 2007.

<sup>12</sup> Commission Press 2007a.

<sup>13</sup> European Court of Justice, *Bertelsmann and Sony Corp of America v Impala*, Case C-413/06 P (hereafter: *Impala II*).

<sup>14</sup> Bavasso 2003, 10-11.

First, a brief overview will be given of the previous case law on the standard of proof incumbent on the Commission in EC merger proceedings. Second, the CFI's criticisms on the 2004 clearance Decision will be discussed. Third, the Commission's reinvestigation of the Sony BMG concentration will be analyzed in light of these criticisms. Fourth, the ECJ's teachings on these matters in *Impala II* and the wider implications of the Sony BMG legal saga for the Commission's evidentiary burden in the context of EC merger control will be identified and commented upon.

## 2 THE STANDARD OF PROOF IN EC MERGER CONTROL: THE CASE LAW BEFORE *IMPALA I*

Neither the old Merger Regulation 4064/89 nor the new EC Merger Regulation (hereafter: 'ECMR') make any reference to the standard of proof incumbent on the Commission in its merger decisions, so it is necessary to look at the case law of the Community Courts for guidance. At the outset, it must be noted that a definite and precise standard of proof has yet to be articulated. Indeed, the Courts usually refer to the 'requisite legal standard' without explaining what that standard actually is.<sup>15</sup> Furthermore, it has been argued that, even though the use of the term 'requisite legal standard' has remained consistent over the years, the application of this standard seems to tell a different story.<sup>16</sup>

In *Commission v Tetra Laval* (hereafter: '*Tetra Laval II*') (2005), the ECJ clarified that the evidence relied on needs to be "*factually accurate, reliable and consistent*", should contain "*all the information which must be taken into account in order to assess a complex situation*" and must be "*capable of substantiating the conclusions drawn from it*".<sup>17</sup> As the CFI phrased it recently, it is not enough for the Commission to put forward a series of logical but hypothetical developments (which it fears would have harmful effects for competition):

"Rather, the onus is on it to carry out a specific analysis of the likely evolution of each market on which it seeks to show that a dominant position would be created or strengthened as a result of the merger and to produce convincing evidence to bear out that conclusion".<sup>18</sup>

In its appeal against *Tetra Laval I* (2002) the Commission had claimed that the CFI, by requiring it to constitute "*convincing evidence*"<sup>19</sup> that a proposed merger "*in all likelihood*"<sup>20</sup> will give rise to significant anticompetitive effects, imposed a disproportionate standard of proof for merger prohibition decisions that is impossible to meet in practice.<sup>21</sup> It took the view that this test differed substantially, both in degree and in nature, from the requirement to produce "*cogent and consistent*" evidence the ECJ established in *Kali & Salz* (1998).<sup>22</sup> The ECJ nonetheless discarded the Commission's arguments in *Tetra Laval II* (2005) by stating that the CFI, in its call for a precise examination supported by convincing evidence "*by no means added a condition relating to the requisite standard of proof but merely drew attention to the essential function of evidence, which is to establish convincingly the merits of a decision on a merger*".<sup>23</sup>

Both *Tetra Laval* judgments thus essentially recapitulate the principle that, where the Commission finds that a concentration would lead to a situation in which effective competition in the common market is significantly impeded, it must provide cogent and consistent evidence to support its decision. This is the very standard that was set out by

<sup>15</sup> According to Sir Christopher Bellamy, a former president of the CFI, the reason for this must be sought in the different legal traditions of the EC judges. See Bellamy 1997, 105.

<sup>16</sup> Bailey 2003, 845-88.

<sup>17</sup> European Court of Justice, *Commission v Tetra Laval*, Case C-12/03 P (hereafter: *Tetra Laval II*), par. 39.

<sup>18</sup> Court of First Instance, *General Electric v Commission*, Case T-210/01, par. 429.

<sup>19</sup> See, e.g., CFI, *Tetra Laval I*, Case T-5/02, par. 155, 162, 223, 256 and 281.

<sup>20</sup> *Idem.*, par. 153.

<sup>21</sup> Commission Press Release 2002.

<sup>22</sup> European Court of Justice, *France and others v Commission*, Case 30/95, par. 228.

<sup>23</sup> ECJ, *Tetra Laval II*, Case C-12/03 P, par. 41.

the ECJ in *Kali & Salz* – a standard that, although considered to be high, was instantly recognized by the Commission in *Price Waterhouse/Coopers & Lybrand*.<sup>24</sup> With regards to the prospective analysis, the ECJ acknowledged that merger control requires a difficult assessment of the way in which a proposed concentration might alter the factors determining the level of competition on a given market. Since this entails a prediction of events, and not an examination of current or past events (as is the case for antitrust investigations), this analysis needs “*to be carried out with great care*”.<sup>25</sup> Furthermore, it is necessary “*to envisage various chains of cause and effect with a view to ascertaining which of them are the most likely*”.<sup>26</sup> This supports the general observation that the Community Courts have a ‘balance of probabilities’ standard rather than a ‘beyond reasonable doubt’ standard in mind in the field of merger control. Given the flexibility inherent a ‘balance of probabilities’ standard, this still raises the question as to what the actual degree of likelihood is that the Commission’s fact-finding and analysis in merger cases must meet. The remaining part of this paper will discuss what lessons can be learned from the Sony BMG merger case in this regard.

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<sup>24</sup> Commission Decision IV/M.1016 on *Price Waterhouse/Coopers & Lybrand* 1999, par. 27.

<sup>25</sup> ECJ, *Tetra-Laval II*, Case C-12/03 P, par. 43.

<sup>26</sup> *Idem.*, par. 43. Emphasis added.

### 3 THE 2004 SONY BMG CLEARANCE DECISION AND THE CFI'S *IMPALA I* RULING

In January 2004, Sony and Bertelsmann notified to the Commission their plans to merge their recorded music business. The proposed concentration was still assessed under the old Merger Regulation 4064/89. Because the Commission found that the transaction raised serious collective dominance concerns, it decided to initiate an in-depth investigation.<sup>27</sup> This hardly came as a surprise: the Commission had already entertained similar concerns on the 1998 merger between Seagram and Polygram, which reduced the number of majors from six to five, and on the withdrawn EMI/Time Warner merger.<sup>28</sup> Yet, in light of the parties' response to the Statement of Objections (cfr. *infra*), the Commission remarkably changed its position and eventually cleared the merger on July 19, 2004.<sup>29</sup> After the approval of the merger by competition authorities around the world (e.g., the United States, Australia, Canada, Switzerland, Poland, and South Africa),<sup>30</sup> the Commission thus too gave green light for the creation of Sony BMG, a fully functional (50-50) joint venture incorporating the parties' activities in the discovery and development of artists<sup>31</sup> and in the marketing and sale of sound recordings.

The Commission's findings on market transparency and the use of retaliation formed the essential grounds of the first clearance Decision. These two elements constitute the most prominent elements of the substantive test that was put forward by the CFI in its judgment in *Airtours*.<sup>32</sup> The CFI clarified that, for a finding of collective dominance, it must be established that:

1. there is sufficient market transparency so to allow spotting deviations from the common policy;
2. there are adequate deterrents to ensure that there is an incentive not to depart from the common policy; and
3. the benefits of coordination are not jeopardized by the action of current and future competitors or consumers.

To assess the degree of market transparency in the market for recorded music, the Commission examined whether it could identify coordinated price policy. For this purpose, price developments over the previous three to four years were considered (with a particular focus on the United Kingdom, France, Germany, Italy, and Spain). The Commission further examined the development of the average wholesale net prices for the top 100 albums of each year, whether any parallelism could have been reached on the basis of published prices to dealers (hereafter: PPDs), and whether the different majors' discounts were aligned and sufficiently transparent. On the basis of the average net prices, the Commission found some parallelism and a relatively similar price development for the albums of the majors. It also found that PPDs are transparent enough to enable monitoring of other major's list pricing. Nevertheless, the Commission concluded that these

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<sup>27</sup> Commission Press Release 2004.

<sup>28</sup> Commission Decision IV/M.1219 on *Seagram/Polygram* 1998, *par.* 26 and 29. The fact that EMI and Time Warner gave up the merger was not only due to the Commission's alarming preliminary conclusions, but should also be seen as a concession to enable Time Warner and AOL to merge (Ranaivoson 2006, 8).

<sup>29</sup> Commission Decision COMP/M.3333 on *Sony/BMG* 2004.

<sup>30</sup> Not to mention, the Czech Republic, Hungary, Romania, and Mexico. See CFI, *Impala I*, Case T-464/04, *par.* 229.

<sup>31</sup> These are the so-called Artist & Repertoire ("A&R") activities, in essence the music industry's research and development.

<sup>32</sup> Court of First Instance, *Airtours v Commission*, Case T-342/99, *par.* 62.

observations could not constitute sufficient evidence of coordinated pricing behavior in the past. Moreover, it reasoned that certain deficits in the transparency of campaign discounts render the market opaque so that price coordination by the majors would require further monitoring at the level of individual albums. In the Commission's view, it could not be established that the publication of hit charts nor Sony and BMG's weekly sale reports ensured the necessary degree of transparency of competitor's campaign discounts. No real evidence was found that the reduction of major recording companies from five to four would significantly facilitate transparency; the Commission accordingly concluded that the concentration was also not likely to create a collective dominant position.

In *Impala I*, the CFI pointed out that the Commission principally mentioned factors that “*far from demonstrating the opacity of the market, show, on the contrary, that the market was transparent*”.<sup>33</sup> It particularly emphasized that the observed sources of price transparency (e.g., the public nature of PPDs and the limited number of reference prices) are capable of giving rise to a high level of transparency. The Court furthermore dismissed the finding that list prices of albums are rather aligned as a “*prudent conclusion to say the least*” since “*the alignment was in fact very marked*”.<sup>34</sup> Subsequently, the CFI heavily criticized the Commission for countering the claim of transparency with the “*rather limited and unsubstantiated*” assertion that campaign discounts could reduce transparency and make tacit collusion more difficult.<sup>35</sup> It furthermore reproached the Commission for basing its findings solely on data relating to - and prepared by - the notifying parties. While the CFI acknowledged that the Commission could not ascertain in the slightest detail the reliability of all the information submitted to it, it nevertheless stated that the Commission “*cannot go so far as to delegate, without supervision, responsibility for conducting certain parts of the investigation to the parties to the concentration*”.<sup>36</sup>

After a thorough review of the findings relating to market transparency, the CFI briefly examined the Commission's assessment concerning retaliation. The Commission identified two measures that could represent possibilities for retaliation against any ‘cheating’ major,<sup>37</sup> but found no evidence that such means have been used or threatened in the past. The CFI observed, however, that the Commission had not substantiated this assertion. Furthermore, the CFI disagreed with the Commission's view that it would be necessary to establish an absence of retaliatory action. On the contrary, it held that the mere existence of punishment mechanisms is in principle sufficient to establish collusion. Hence, the CFI concluded that the analysis in the Decision relating to retaliation is, like the assessment of market transparency, vitiated by an error of law and a manifest error of assessment.

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<sup>33</sup> *Idem.*, par. 290.

<sup>34</sup> *Ibid.*, par. 299.

<sup>35</sup> *Ibid.*, par. 294. The Court invalidated the Commission's reasoning in a forceful manner: “Clearly, such vague assertions, which fail to provide the slightest detail of, in particular, the nature of campaign discounts, the circumstances in which such discounts might be applied, their degree of opacity, their size or their impact on price transparency, cannot support to the requisite legal standard the finding that the market is not sufficiently transparent to allow a collective dominant position” (*Ibid.*, par. 289).

<sup>36</sup> *Ibid.*, par. 415. The CFI found this to be particularly problematical in light of the observations that the alleged opacity constituted the crucial element on which the Decision is based.

<sup>37</sup> These include (1) a return to competitive behavior or (2) the exclusion of the deviator from compilation joint ventures (e.g., the refusal to license tracks for the deviator's compilation albums).

## 4 THE REEXAMINATION OF THE SONY BMG MERGER: A SECOND ATTEMPT TO JUMP THE FENCE

The annulment of the 2004 Sony BMG Decision gave the Commission a second chance to prove that it has the necessary resources and expertise to meet the Community Courts' standards. After the case was re-notified to the Commission in January 2007, the Commission started its new assessment of the Sony BMG joint venture. Even though the new investigation was still carried out under the previous Merger Regulation - under which the Commission had to assess whether the merger would strengthen or create a collective dominant position in the EEA as it stood before May 1, 2004 - the Commission decided to reexamine the transaction under current market conditions.<sup>38</sup> Consequently, the Commission was able not only to assess the actual impact of the merger but also to take into account the development of the digital music market since 2004. In 2004, this market was still in a state of infancy. This situation has changed considerably as the majors have since then adopted their strategy on digital sales. The new market investigation confirmed that, from both the demand side and supply sides, this market could be distinguished from the physical market. The situations in both markets were therefore analyzed separately.

### 4.1 The market for recorded music in digital formats

On the basis of market shares, the Commission at the outset concluded that the merger has not led to a position of single dominance in the national markets for digital distribution of music or to market foreclosure. Given the absence of non-coordinated effects, the Commission assessed whether the concentration has led to a creation or strengthening of a collective dominant position on the wholesale market for the licensing of music to digital music providers. For this purpose, it conducted an in-depth investigation of both the contracts between the majors and the most important digital music service providers and of price developments in all the affected markets (for the period between 2004 and 2007). The pricing data showed that the majors apply different prices and price structures and use different business models: rather than coordinating their activities, record companies thus appear to individually maximize their returns on recorded music in digital form.

As regards market transparency, the Commission observed that digital retail market pricing is more standardized than in the physical market due to the importance of iTunes as a price setter. iTunes is the leading music provider worldwide with a market share in Europe of at least 50 percent and it applies uniform prices. The competing digital music providers tend to follow Apple's "one-size-fits-all" pricing model. The market investigation moreover indicated that a number of elements considerably limit the ability of the majors to reconstruct wholesale prices or to identify any deviation regarding wholesale pricing on the basis of retail prices. The Commission particularly pointed to the increasing diversity and complexity of wholesale pricing structures and agreements. As there are no PPDs in the digital market that could function as a focal point for coordination, the Commission concluded that there is not sufficient transparency to monitor whether the coordinated terms are adhered to. No indications were found that the merger would increase market transparency.

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<sup>38</sup> Commission Press Release 2007b.



As regards retaliation, the Commission found no credible deterrent mechanisms for the majors to reinstate adherence to any agreed collusive scheme. It emphasized that the wholesale prices of the majors vary considerably in different directions without any observable reaction of the majors.

As regards the ability of competitors or consumers to engage in countervailing measures, the market investigation showed that independents exert only limited competitive pressure on the majors. Customers on the other hand could jeopardize to a certain extent the benefits of any coordination. iTunes in particular was found to have a strong impact on the recording companies' pricing decisions. According to the Commission, the creation of Sony BMG did not affect the balance of power that currently exists between the majors on the one hand and iTunes (and increasingly a number of other strong players, e.g., telecom operators) on the other.

## 4.2 The market for recorded music in physical formats

In analyzing the market for recorded music, the Commission significantly widened its new market investigation in response to the CFI's criticisms in *Impala I* (cfr. supra). The Commission extended its original analysis of the top 100 sales by collecting data on net prices, discounts and wholesale prices for all CD chart albums sold by all majors in all the 15 affected markets for the period between 2002 and 2006 - equivalent to millions of data points. In addition to these quantitative aspects, it investigated the nature of discounts and the circumstances in which record companies use discounts to diminish their PPDS and the merger's impact on consumer choice in terms of cultural diversity.

As regards market transparency, the Commission scrutinized five theories of harm that had been suggested during the market investigation.<sup>39</sup> It assessed the criteria of transparency against each theory of price-related coordination, because each theory requires a specific level of transparency. The Commission considered that a coordination of the prices of the merging parties' new (chart) album releases is the most likely theory as the bulk of sales of major recording companies are realized in the first weeks following the release. The investigation indicated, however, that the level of transparency (that characterizes PPDs, discounts, and markups applied to retail prices) was not particularly high. The study of the discount stability confirmed that, even in the hypothetical case of full transparency of PPDs, a significant number of sales transactions would not follow a simple and stable pattern that could be inferred on the basis of public information.

As regards retaliation, two potential mechanisms were evaluated: (1) the exclusion of the deviating company from compilation joint ventures or joint activities, and (2) the termination of the tacitly coordinated behavior with respect to prices and releases of albums. The Commission reasoned that the absence of an observable alignment confirmed that these mechanisms are no credible means of retaliation.

As regards countervailing abilities, the Commission again concluded that the independents are not likely to jeopardize the expected outcome from any coordinated behavior. Similar to the findings concerning the digital music market, it found that at least a sizeable

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<sup>39</sup> These include (i) coordination at the level of budgets; (ii) coordination at the level of each title pricing; (iii) coordination at the level of pricing policy (stabilization of current business model); (iv) coordination on prices at and shortly after the release date; and (v) coordination at the level of non-price terms (Commission Decision COMP/M.3333 on *Sony/BMG 2007*, par. 530-634).

proportion of customers (e.g., supermarkets) were on the contrary capable of destabilizing coordination by majors by reducing purchases and advertising on their products.

On the basis of the above considerations, the Commission again concluded that there was no factual evidence to demonstrate that the notified operation would lead to a strengthening or creation of a collective dominant position on the online and offline markets for recorded music.

### 4.3 The evidence in the Commission's 2007 Sony BMG Decision

The evidence put forward in the 2007 Sony BMG Decision demonstrates that the Commission made substantial attempts to address the CFI's criticisms voiced in *Impala I*. First, the new market investigation can rightfully be called one of the largest and most complex econometric analyses conducted thus far in the context of EC merger control.<sup>40</sup> In addition to the extensive widening of the investigated dataset on the market for recorded music, the Commission also analysed the market for the licensing of recorded music in digital format in the light of its development since 2004. Second, the Commission fully embraced the points that were raised by the CFI on the legal criteria for a finding of a collective dominant position (cfr. *supra*). Third, the Commission clearly took the CFI's criticism that it had solely relied on data relating to and prepared by the notifying parties, to heart. Third-party submissions were taken into account in all instances (i.e. information from other market players - both majors and independents, independent market observers, professionals, and so forth). For example, the Commission received information from *Impala* that the merger of Sony BMG has had a negative impact on cultural diversity, i.e. by furthering the strategy of the majors to reduce their catalogues and local language repertoire. This issue was not (explicitly) addressed in the 2004 Sony BMG Decision, even though the Commission is legally obliged to consider such cultural aspects by Article 151(4) EC. In response to *Impala's* observation, the Commission did examine the impact of the merger of Sony BMG on customer choice in its re-investigation of the transaction. It found that there is, also in view of the customers, still fierce competition among the majors and independents for the discovery and signing of artists. The Commission's analysis showed that between 2002 and 2006 the share of local repertoire (as opposed to international repertoire) has in fact increased in almost every Member State. Moreover, it considered that the Internet proposed considerable prospects for artists to record and present their music to a wider audience themselves. Consequently, the Commission concluded that the Sony BMG merger did not negatively affect cultural diversity.<sup>41</sup>

These observations about the evidence in the 2007 Sony BMG Decision thus seem to indicate that the CFI's *Impala I* judgment has changed the Commission's performance for the better.<sup>42</sup> In what follows, the Commission's second investigation of the Sony BMG merger will be reassessed in light of *Impala II* in order to identify and evaluate the wider implications of the Sony BMG legal saga for EC merger control.

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<sup>40</sup> Commission Press Release 2007a.

<sup>41</sup> Commission Decision COMP/M.3333 on *Sony/BMG 2007*, par. 415-428; Kroes 2007.

<sup>42</sup> For a more detailed analysis of the Commission's 2007 Sony BMG Decision, see Van Rompuy and Pauwels 2008.

## 5 IMPLICATIONS OF THE *IMPALA* RULINGS FOR THE STANDARD OF PROOF IN EC MERGER CONTROL

The publication of the 2007 Sony BMG Decision interestingly coincided with the ECJ's judgment in *Impala II*, which was delivered by a Grand Chamber of 13 judges in July 2007. The ECJ did not give a final judgment on the appeal against *Impala I*, but it did address several important questions of evidence and proof that are of wider relevance for EC merger control. The ECJ's guidance on the following procedural and substantial issues are of particular importance: (1) the symmetrical standard of proof for clearance and prohibition decisions, (2) the applicable legal test for a finding of collective dominance, (3) the role and purpose of the Statement of Objections and (4) the standard of reasoning in merger decisions.

### 5.1 Symmetrical standard of proof

Most significantly, the judgment of the ECJ brings an end to the discussion about whether there exists a bias against or in favor of the compatibility of mergers with the common market. It expressly held that there is nothing in the old Merger Regulation (nor the new ECMR) that indicates that there would be a different standard of proof in relation to decisions approving a concentration on the one hand and decisions prohibiting a concentration on the other.<sup>43</sup> The ECJ essentially referred to the symmetrical requirements laid down by Articles 2(2) and 2(3) of the Regulation:

“2. A concentration which does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared compatible with the common market.

3. A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market”.<sup>44</sup>

In his opinion in *Tetra Laval II*, ECJ Advocate General Tizzano had argued on the contrary that there should be a presumption of the mergers' compatibility with the common market especially when it is difficult to foresee the effects of the notified transaction (so-called 'grey-area' cases). In his view, Article 10(6) of the Merger Regulation undermines the symmetry of the conditions provided in Articles 2(2) and 2(3). The article stipulates that where the Commission has not taken a decision within the time limits set, the notified merger shall be deemed to have been declared compatible with the common market. According to Tizzano, this clearly demonstrates that, in the case of uncertainty, the Community legislature preferred to run the risk of authorizing a transaction that is incompatible with the common market.<sup>45</sup> The ECJ firmly rejected this reasoning and

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<sup>43</sup> ECJ, *Impala II*, Case C-413/06 P, par. 46.

<sup>44</sup> With the adoption of the revised EC Merger Regulation (hereafter: ECMR) in 2004, the substantive test for the compatibility assessment of a concentration changed. From May 1, 2004 on the test has been whether or not a notified concentration would “significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position”. The symmetrical nature of Article 2(2) and (3), however, remains the same.

<sup>45</sup> Opinion of Advocate General Tizzano, ECJ, *Tetra-Laval II*, Case C-12/03 P, par. 78-81.

stressed the provision in question is nothing but an expression of the need for speed in merger review procedures.<sup>46</sup> It is true that a symmetrical standard of proof may pose problems for the Commission when it is confronted with ambiguous evidence. However, as Advocate General Kokott indicated in her opinion on the appeal against *Impala*, there can only be a few small and infrequent ‘grey-area’, borderline cases in which, even after extensive market investigations, it is not clear on which side of the line the case falls.<sup>47</sup> Arguably in these cases the concentration may be presumed to be compatible with the common market. It would be wrong though if the Commission would opt by default for a clearance decision in any case of doubt. In the communication sectors, this would particularly imply that commercial interests would unreservedly override other interests, such as concerns about media pluralism. With regard to the Sony BMG concentration, for example, *Impala* persistently stressed that the transaction was not only problematical in terms of market access but that it would also further marginalize the position of the independents to the detriment of cultural diversity (cfr. *supra* 3.3).<sup>48</sup> But even when one only considers competition issues, an unequal standard of proof in favor of clearance may in practice lead to the undue authorization of anticompetitive mergers. This was precisely the fear that was raised in the aftermath of the three judicial defeats in 2002. If anything, the 2004 Sony BMG Decision demonstrates the drawbacks of an asymmetrical standard of proof. Far from arguing why the merger would not lead to the creation or strengthening of a collective dominant position, the Commission mainly indicated why the evidence was ‘not sufficient’ to underpin a prohibition decision. The ECJ therefore rightfully confirms that the Commission cannot opt for a clearance decision to be on the safe side but rather must always take a fully reasoned decision based on sound evidence. Hopefully, this will also reestablish the legal certainty that a clearance decision will be permanent, as the notifying parties have little control over ensuring that the Commission’s analysis can withstand judicial scrutiny.

## 5.2 Different standards for existing and potential collective dominant positions?

In *Impala I*, the CFI observed that the existing case law on collective dominance had been developed in the specific context of the assessment of the possible *creation* of a collective dominant position. The appraisal of an *existing* collective dominant position is different, the Court argued, because here the Commission has the clear advantage that it can base its findings on a series of elements of established facts (past or present).<sup>49</sup> The CFI therefore suggested that the *Airtours* conditions for a finding of coordinated effects (cfr. *infra*) could be more easily satisfied in the investigation of a preexisting collective dominant position. Most remarkably, the Court indicated that:

“(A)lthough the three conditions (...) are indeed also necessary, they may, however, in the appropriate circumstances, be established 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.

Thus, in particular, close alignment of prices over a long period, especially if they are above a competitive level, together with other factors typical of collective dominant position, might, in the absence of an alternative

<sup>46</sup> ECJ, *Impala II*, Case C-413/06 P, par. 47.

<sup>47</sup> Opinion of Advocate General Kokott, ECJ, *Impala II*, Case C-413/06 P, par. 139.

<sup>48</sup> *Impala*.

<sup>49</sup> CFI, *Impala I*, Case T-464/04, par. 250.

reasonable explanation, suffice to demonstrate the existence of a collective dominant position, even where there is no firm direct evidence of strong market transparency, as such transparency may be presumed in such cases.<sup>50</sup>

Quite in contrast to the often-heard claim that *Impala* imposed a too demanding standard of proof on the Commission, the CFI thus in fact lowered the evidentiary threshold for establishing an existing collective dominant position.<sup>51</sup> Sony and Bertelsmann had submitted that this ‘watered-down’ test constituted a misapplication of the *Airtours* conditions. The ECJ acknowledged that the inherent complexity of a theory of competitive harm cannot, of itself, have an impact on the standard of proof that is required.<sup>52</sup> However, it interestingly did not object to the CFI’s obiter dictum. On the contrary, the ECJ highlighted that “(i)t is necessary to avoid a mechanical approach involving the separate verification of each of those criteria in isolation, while taking no account of the overall economic mechanism of a hypothetical tacit coordination”.<sup>53</sup> This can be seen as an explicit recognition of the difficulties the Commission may encounter when examining collective dominance cases. At the same time, it illustrates that the application of the legal *Airtours* conditions is not clear-cut yet. Unfortunately, the same can be said about the CFI’s teachings in *Impala* on the indirect establishment of the market transparency criterion (e.g. the undefined “*indicia and items of evidence*” or the vague formulation of “*appropriate circumstances*”). While the Commission did explore this approach in its 2007 Sony BMG Decision, it is thus unlikely that it will ever go as far as to substantiate a finding of a pre-existing collective dominance position solely on the basis of indirect signs.

### 5.3 The role and purpose of the Statement of Objections

A further important aspect of the judgment is that the ECJ expressly confirmed the provisional nature of the Statement of Objections (hereafter: SO) in merger review procedures. The SO is a normal procedural act in a second phase merger investigation that enables the parties to exercise their rights of defense. It sets forth the Commission’s preliminary findings both on the facts and on their legal and economic significance. This is of great importance, as the Commission can only base its decision on objections on which the parties have been able to submit their observations.<sup>54</sup>

Contrary to its final decision, the Commission had argued in its SO that the notified Sony BMG merger was incompatible with the common market. As explained above, it provisionally concluded that the merger would strengthen an existing collective dominance position and that the market for recorded music was transparent and particularly conducive to coordination. The CFI not only found this “*fundamental U-turn in the Commission’s position*” surprising, but also harshly criticized the Commission for not being capable of demonstrating how the previous findings were incorrect:

“unless the entire investigative administrative procedure is to be deprived from the slightest value, the Commission must be able to explain, not in the decision, admittedly, but at least in the context of the proceedings

<sup>50</sup> *Ibid.*, par. 251-252. Emphasis added.

<sup>51</sup> See e.g. Aigner, Budzinski and Christiansen 2006; Simpson and Tatcher 2007.

<sup>52</sup> ECJ, *Impala II*, Case C-413/06 P, par. 51.

<sup>53</sup> *Ibid.*, par. 125.

<sup>54</sup> Art. 18(3) ECMR.

before the Court, its reasons for considering its provisional findings were incorrect”.<sup>55</sup>

In overruling the CFI, the ECJ rightfully observed that these remarks on the relationship between the contested Decision and the SO could not be minimized as “*unfortunate choices of expression*”, as Advocat General Kokott put forward in her opinion. It found on the contrary that the CFI erroneously treated what it termed ‘findings of fact made previously’ in the SO “*as being more reliable and more conclusive than the findings set out in the contested decision itself*”.<sup>56</sup> The ECJ deemed this to be an error of law and stressed that “*it should not be assumed that the assessments made in a SO cannot be modified in the light of the replies to such a statement*”.<sup>57</sup> The fact that the Commission is, by contrast to the position under Articles 81 EC and 82 EC, subject to strict time limits thus has no effects on the preparatory nature of the SO.

This clarification certainly has to be welcomed. The extent to which the CFI used the SO as a benchmark for its review was unseen and already had adverse consequences beyond the fact of the case. Since the CFI’s *Impala* judgment in 2006, the Commission simply avoided the issuance of a SO in about one-third of the merger case it has cleared following a second phase investigation.<sup>58</sup> The obvious drawback of this approach is that it seriously impedes the parties’ rights to properly defend themselves, on the basis of all the necessary information, before the Commission adopts a formal decision. Another strategy was followed in e.g. *Ineos/BP Dormagen*.<sup>59</sup> After examining the parties’ response to the SO, the Commission made use of its investigative powers under Article 11 ECMR to request information from competitors in order to assess the validity of the evidence that was submitted.<sup>60</sup> This approach also has tough limitations. Because of the mandatory time restrictions governing the adoption of decisions, there is very little room for conducting fresh investigations. Interestingly, the ECJ acknowledged this by holding that the Commission “*cannot, in principle, be required, in every individual case, to send, following communication of the objections and after hearing the undertakings concerned, requests for extensive information*”.<sup>61</sup> Not in the least because it also held that the same standard of proof should apply to arguments of the notifying parties submitted in reply to the SO than to those submitted at an earlier stage.

#### 5.4 Adequate statement of reasons

The ECJ furthermore clarified the standard of reasoning the Commission is required to satisfy in its decisions. It reiterated that the essential purpose of the statement of reasons is to enable the Community Courts to exercise their judicial review. In that regard, the ECJ stressed that a distinction should be made between the procedural requirement to state adequate reasons and the question whether this reasoning is well founded. In other words, the statement of reasons can be adequate even when it sets out reasons that are incorrect. The ECJ observed that the CFI was clearly aware of the reasons for which the Commission decided to approve the concentration. It subsequently concluded that the reasoning in the

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<sup>55</sup> CFI, *Impala I*, Case T-464/04, par. 335.

<sup>56</sup> ECJ, *Impala II*, Case C-413/06 P, par. 71.

<sup>57</sup> *Ibid.*, par. 75.

<sup>58</sup> Brandenburger, Janssens and Aitken 2008, 9.

<sup>59</sup> Commission Decision COMP/M.4094 on *Ineos/BP Dormagen* 2007. The Decision was taken in August 2006, only a few weeks after the *Impala* judgment. In this case, Ineos (a U.K.-based company active in the production, distribution sales, and marketing of chemicals) sought to acquire BP Dormagen Business (a Germany-based company active in the production of ethylene oxide and ethylene glycols).

<sup>60</sup> *Ibid.*, par. 4.

<sup>61</sup> ECJ, *Impala II*, Case C-413/06 P, par. 91.

contested Decision was adequate for a third party complainant - in this case Impala - to challenge its validity.<sup>62</sup>

By reversing the CFI's finding that the reasoning of the 2004 Sony BMG Decision was inadequate, the ECJ did not follow the criticisms voiced by A.G. Kokott. In her opinion, she stated that:

“Simply put, in a merger control decision which to a large extent reads as if it were a prohibition decision, it is essential that a sufficiently precise explanation is given of the considerations on the basis of which the matter ultimately turns, even for informed readers who are familiar with the market”.<sup>63</sup>

The ECJ did not object to the fact that the Decision made numerous comments adverse to the merger and set out only briefly the reasons for clearance. The Court admitted that there was “*a certain imbalance in the contested decision*” in the presentation of the reasons. But it stressed that the degree of precision of the statement of the reasons for a decision must be weighed against “*practical realities and the time and technical facilities available for making the decision*”.<sup>64</sup> The Court moreover found that it was unreasonable of the CFI to require a detailed description of each of the factors underpinning the Commission's decision as “*it is not necessary for the reasoning to go into all the relevant facts and points of law*”.<sup>65</sup> The ECJ's sympathy for the particular context in which the 2004 Sony BMG Decision was adopted and the margin this provides for the Commission in stating the reasons for a decision, is remarkable.<sup>66</sup> It even appears to be inconsistent with the Court's call to establish convincingly the merits of a decision on a merger. While it is certainly true that the importance the CFI attributed to the SO in *Impala I* (cfr. supra) had swung the pendulum too far, the Commission should be capable of explaining the reasons for a fundamental change in its position. Not in the least when it completely reverses this initial position - based on an investigation lasting five months - only at the very end of the formal merger proceeding, as was the case in the first investigation of the Sony BMG merger.

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<sup>62</sup> *Ibid.*, par. 181.

<sup>63</sup> Opinion of Advocate General Kokott, ECJ, *Impala II*, Case C-413/06 P, par. 124.

<sup>64</sup> ECJ, *Impala II*, Case C-413/06 P, par. 167.

<sup>65</sup> *Ibid.*, par. 166.

<sup>66</sup> Brandenburg, Janssens and Aitken 2008, 15.

## 6 CONCLUSIONS

The tsunami of judicial defeats in 2002 prompted the Commission to fundamentally reform its merger control review process. The Commission needed to improve the quality of its decisions, by e.g. advancing the use of economic analysis. The annulment of the 2004 Sony BMG Decision, which was supposed to be representative of an economically sophisticated merger control and of a more cautious approach towards prohibition, was therefore generally perceived as a crushing defeat for the Commission. A careful analysis of the judgment has shown that the implications of *Impala I* are indeed not without problems. The extent to which the CFI used the SO as a benchmark for its review of the 2004 Sony BMG Decision was particularly troublesome. The fact that the ECJ heavily criticized the CFI for treating conclusions set out in the SO as established is therefore welcomed. A further problematic aspect of *Impala I* is the CFI's insistence on obtaining data from third parties. The Commission's increasingly lengthy and demanding information requests in the aftermath of the judgment already illustrate the additional burden on the Commission and the (third) parties.

The analysis did not confirm, however, that *Impala I* would have significantly raised the standard of proof in EC merger proceedings. The CFI in fact lowered the evidentiary threshold for establishing an existing collective dominant position (even though its statements on the *Airtours* test are not unambiguous). This might be recognition of the fact that the conditions for the finding of collective dominance might be too difficult to establish in practice, especially in complicated "grey area" cases. The fear that this in turn would lead to the undue clearance of anti-competitive mergers, is precisely the reason why the *Impala* judgments have to be welcomed for clarifying that the standard of proof is equal for clearance and prohibition decisions. The ECJ rightfully confirmed that the Commission cannot opt for a clearance decision to be on the safe side but rather must always take a fully reasoned decision based on sound evidence.

When asked in a 2002 interview whether the Commission has the necessary resources to meet the Community Court's standards, the president of the CFI responded that it did not, but that this could not refrain the Court from striking down flawed decisions.<sup>67</sup> In the last five years, the Commission has made various attempts to enhance the combination of legal and economic expertise in its analysis of merger cases. However, the reliance on economic analysis and its empirical support does not in itself guarantee better decision-making. Given the annulment of the first clearance Decision, the reassessment of the Sony BMG joint venture is therefore of great strategic importance for the credibility of EC merger control. It has given the Commission a second chance to prove that its 'more economic approach' is more than just a bumper sticker. The analysis of the 2007 Sony BMG Decision indicated that this attempt has been successful. In addition to the quantitative data, the Commission also gathered information on qualitative aspects of the concerned markets. It is particularly notable that the Commission, in response to observations of *Impala*, investigated the consequences of the merger on cultural diversity. The Commission's hesitance to invoke or even refer to Article 151(4) EC - which requires the Commission to take cultural aspects into account in all of its actions - illustrates the continuing lack of political courage to give weight to cultural diversity considerations in its merger decisions. Nonetheless, it is an important step forward in comparison to the 2004 Decision. To a certain extent it also suggests that the push for more economic analysis is not necessarily

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<sup>67</sup> Burnside 2002; Quatremer 2002.



detrimental to the consideration of non-economic objectives. Particularly for the communications sector, where the application of the competition rules may give rise to a diversity of non-economic concerns, this is a reassuring observation.

Unfortunately it is doubtful that the Commission will be able to conduct an equally thorough investigation in a normal, very time-constrained merger review procedure. It must be remembered that the reinvestigation of the Sony BMG merger is atypical in at least two ways. For one thing, the Commission was in a unique position to investigate the actual impact of the merger since it was already implemented for one to three years, depending on the territory. The need for a prospective analysis to evaluate the likelihood of the creation of a (collective) dominant position was therefore limited. What is more, the normal time pressure to adopt a decision was far less present. The 2007 Sony BMG Decision was adopted 15 months after the annulment of the first Decision, whereas a normal procedure has a tight schedule of 20 or 115 (in the case of a Phase II proceeding) working days. Consequently, the Commission may have set itself an impossible precedent with the 2007 Sony BMG Decision. The observation that the Commission has avoided the formal SO stage in several recent merger proceedings - arguably out of fear of judicial review - already seems to imply that the Commission is not entirely confident it can jump the fence again in a similar fashion. The ECJ's emphasis on the provisional and preparatory nature of the SO will hopefully now reverse this trend.

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