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Antitrust and Competition Law Update: Tetra Laval–A landmark judgement on EC Merger Control

Ulrich Quack* Claus-Dieter Ehlermann† James Burling‡

John Ratliff** Suyong Kim††

Douglas Melamed‡‡ William Kolasky§

*WilmerHale

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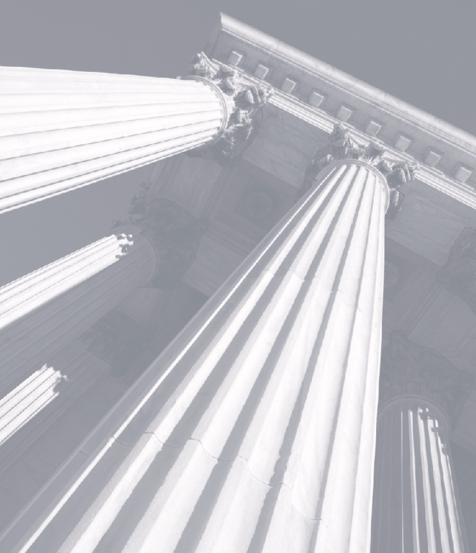
Antitrust and Competition Law Update: Tetra Laval–A landmark judgement on EC Merger Control

Ulrich Quack, Claus-Dieter Ehlermann, James Burling, John Ratliff, Suyong Kim, Douglas Melamed, and William Kolasky

Abstract

On 15 February 2005, the European Court of Justice (ECJ) dismissed the European Commission's appeal in the Tetra Laval/Sidel merger case.2 The ECJ's judgment establishes two signi?cant principles that apply beyond the facts of this particular case:The judgment con?rms that the Court of First Instance (CFI) for all practical purposes will continue to be the ultimate arbiter of disputes about the Commission's use of evidence and economic assessment in merger control proceedings. The ECJ has signaled that it will generally not entertain appeals asserting that the CFI engaged in excessive scrutiny of the Commission's assessment and therefore overstepped the permissible boundaries of judicial review. Had the ECJ upheld the arguments raised by the Commission, this may well have had a chilling effect on the CFI's willingness to subject the Commission's merger decisions to strict scrutiny. This in turn would have severely limited the effectiveness of judicial review, in particular in the age of the Commission's "more economics-based approach" and the increasing importance of complex factual and economic evidence in merger cases. • While the judgment does not preclude prohibition of conglomerate mergers under the Merger Regulation, it imposes stringent legal and practical constraints on the Commission's ability to challenge such mergers on the basis of "leveraging"- type theories of competitive harm: Finding that "the chains of cause and effect [underlying leveraging theories] are dimly discernible, uncertain, and dif?cult to establish", the ECJ required a particularly high quality of evidence to support a conclusion that the leveraging developments will occur following the merger. By requiring that the Commission examine on a case-by-case basis whether behavioral commitments (such as not to bundle different products)

might be effective, the ECJ's judgment makes it less likely that the Commission will pursue leveraging theories in merger review. The judgment effectively compels the Commission to reassess its method of evaluating commitments, which currently calls for the rejection of even the most carefully crafted long-term behavioral commitments that adequately address conglomerate concerns.



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ANTITRUST AND COMPETITION LAW UPDATE

11 March 2005

Tetra Laval–A Landmark Judgment on EC Merger Control[1]

On 15 February 2005, the European Court of Justice (ECJ) dismissed the European Commission's appeal in the *Tetra Laval/Sidel* merger case.[2] The ECJ's judgment establishes two significant principles that apply beyond the facts of this particular case:

- The judgment confirms that the Court of First Instance (CFI) for all practical purposes will continue to be the ultimate arbiter of disputes about the Commission's use of evidence and economic assessment in merger control proceedings. The ECJ has signaled that it will generally not entertain appeals asserting that the CFI engaged in excessive scrutiny of the Commission's assessment and therefore overstepped the permissible boundaries of judicial review. Had the ECJ upheld the arguments raised by the Commission, this may well have had a chilling effect on the CFI's willingness to subject the Commission's merger decisions to strict scrutiny. This in turn would have severely limited the effectiveness of judicial review, in particular in the age of the Commission's "more economics-based approach" and the increasing importance of complex factual and economic evidence in merger cases.
- While the judgment does not preclude prohibition of conglomerate mergers under the Merger Regulation, it imposes stringent legal and practical constraints on the Commission's ability to challenge such mergers on the basis of "leveraging"-type theories of competitive harm:
  - o Finding that "the chains of cause and effect [underlying leveraging theories] are dimly discernible, uncertain, and difficult to establish", the ECJ required a particularly high quality of evidence to support a conclusion that the leveraging developments will occur following the merger.
  - o By requiring that the Commission examine on a case-by-case basis whether behavioral commitments (such as not to bundle different products) might be effective, the ECJ's judgment makes it less likely that the Commission will pursue leveraging theories in merger review. The judgment effectively compels the Commission to reassess its method of evaluating commitments, which currently calls

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1. Wilmer Cutler Pickering Hale and Dorr LLP represented Tetra Laval in the initial administrative proceedings before the Commission, and was co-counsel in the litigation before the CFI and the ECJ.

2. Case C-12/03 P, *Commission v. Tetra Laval*, judgment of 15 February 2005, not yet reported. In a second judgment (Case C-13/03 P) the ECJ declared as devoid of purpose the Commission's related action requesting the annulment of the CFI's judgment that rendered void the Commission's divestiture decision in the *Tetra Laval/Sidel* case.

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for the rejection of even the most carefully crafted long-term behavioral commitments that adequately address conglomerate concerns.

The Tetra Laval/Sidel Saga

The ECJ's judgment ends a long-running saga. Tetra Laval, through its Tetra Pak business, is the leading manufacturer of aseptic and non-aseptic carton packaging systems. Sidel is a leader in PET packaging equipment, in particular stretch-blow molding (SBM) machines for making empty PET bottles. In October 2001, the Commission prohibited Tetra Laval's proposed acquisition of Sidel based on conglomerate concerns. It argued that the transaction would allow Tetra Laval to leverage its market power into a neighboring market, and eliminate potential competition across packaging systems. Tetra Laval appealed the prohibition decision to the CFI, which in its judgment of 25 October 2002 comprehensively rejected the Commission's substantive assessment. In the light of the CFI's annulment of the original Commission decision, Tetra Laval re-notified the transaction for a second review by the Commission. On 13 January 2003, the Commission approved the transaction without opening a detailed second-phase investigation. While the Commission's clearance decision allowed Tetra Laval to close the transaction, the Commission appealed the CFI's judgment to the ECJ on 8 January 2003.

The Commission's appeal raised fundamental questions about the standard of judicial review and the Commission's burden of proof in merger cases generally, and with respect to conglomerate mergers in particular. The Commission's appeal also questioned the obligations imposed by the CFI to take into account the possible illegality of leveraging predicted by the Commission, as well as behavorial commitments not to engage in leveraging-type behavior.[3]

> *"...not only must the Community Courts, inter alia, establish whether the evidence relied on is factually accurate, reliable and consistent,* but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it."

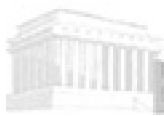
Standard of Judicial Review

At the core of the Commission's appeal was its claim that the CFI's judgment imposed too heavy a burden of proof on the Commission when reviewing mergers and thereby departed from a standard of judicial review previously defined by the Community Courts. The Commission argued that in its judgment, rather than requiring a body of "cogent and consistent" evidence, the CFI had obligated the Commission to produce "convincing evidence" when challenging a merger. According to the Commission, this "new" standard unduly limited the discretion it needed to have in cases involving complex factual and economic matters. The Commission argued that the CFI had effectively transformed its role into that of a body with full competence to rule on matters in all their complexity and thus entitled to substitute its views for those of the Commission.

The ECJ disagreed with the Commission's views. In the ECJ's words, "not only must the Community Courts, inter alia, establish whether the evidence relied on is factually accurate, reliable and consistent, *but also whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it"* (para. 39, emphasis added). On that basis, the CFI's requirement that proof of the anti-competitive effects of a merger calls for "a precise examination, supported by convincing evidence, of the circumstances which allegedly produce those effects" is not a new standard imposed upon the Commission, but simply a reflection of the essential function of evidence, which is to establish convincingly the merits of a merger decision.

The ECJ did not adopt the view suggested by Advocate General Tizzano, that the division of power between the Commission

3. The Commission also appealed on three other grounds that are more specific to the facts at issue in the case. The ECJ rejected all of these as either inadmissible or unfounded.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and the Community judicature did not allow the CFI "to enter into the merits of the Commission's complex economic assessment or to substitute its own point of view for that of the institution".[4] The ECJ in particular did not share Tizzano's criticism that the CFI had substituted its own judgment for that of the Commission with regard to an important part of the analysis, *i.e.,* the predicted growth of PET packaging for a number of "sensitive" beverages. Unlike the Advocate General, the ECJ dismissed the Commission's arguments in this respect in two short paragraphs. The ECJ pointed out that these arguments relate to findings of fact that the CFI was able to base on various items in the contested decision itself.

The ECJ thus confirmed the fundamental role of the CFI in the review of merger cases. While the CFI will continue to exercise judicial self-restraint with respect to technical questions, the need to respect the Commission's "margin of discretion" will not prevent the CFI from looking closely at the Commission's analysis. This is particularly important in view of the increasingly sophisticated economic analysis and evidence that is offered up in contested merger cases. For the merging parties, the length of proceedings before the CFI already limits the effectiveness of judicial review as a practical matter. Shielding the Commission's decisions from judicial scrutiny simply because of the apparent complexity of the economic assessment would have made litigation in merger cases even less of an option.

Burden of Proof and Presumptions

The ECJ also addressed the Commission's burden of proof in merger cases generally and conglomerate merger cases specifically. The ECJ referred to the difficulties inherent in merger review and noted that "a prospective analysis of the kind necessary in merger control *must be carried out with great care* since it does not entail the examination of past events [...], but rather a prediction of events which are more or less likely to occur in [the] future if a decision prohibiting the planned concentration or laying down the conditions for it is not adopted" (para. 42, emphasis added).

For conglomerate mergers, the ECJ made more explicit the evidentiary obligation it expects the Commission to discharge: "The analysis of a "conglomerate-type" concentration is a prospective analysis in which, first, the consideration of a lengthy period of time in the future and, secondly, 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. That being so, the quality of the evidence produced by the Commission [...] is particularly important." (para. 44). The ECJ highlighted the difficulties inherent in proving a leveraging theory[5] and endorsed the "hard look" at the evidentiary record performed by the CFI.

Interestingly, the ECJ did not explicitly address the Commission's argument that this burden of proof effectively creates a presumption in favor of the legality of mergers (or at least conglomerate mergers), whereas the Merger Regulation imposes "symmetrical" obligations upon the Commission–meaning that it has to meet the same standard of proof regardless of whether it is clearing or prohibiting a transaction.[6] The Advocate General had explicitly rejected the

While the CFI will continue to exercise judicial self-restraint with respect to technical questions, the need to respect the Commission's "margin of discretion" will not prevent the CFI from looking closely at the Commission's analysis. This is particularly important in view of the increasingly sophisticated economic analysis and evidence that is offered up in contested merger cases.

4. Opinion of AG Tizzano of 25 May 2004, not yet reported, para. 89.

5. See Völcker, *Leveraging as a theory of competitive harm after Tetra Laval,* 40 C.M.L.Rev. 581-614 (2003).

6. According to Article 2(2) ECMR (in its amended version), "a concentration which would not significantly impede effective competition in the common market [...] shall be declared compatible with the common market". On the other hand, according to Article 2(3) ECMR (in its amended version), "a concentration which would significantly impede effective competition in the common market [...] shall be declared incompatible with the common market".

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Commission's "symmetry" argument, holding that in the "grey area" of cases in which it is particularly difficult to foresee the effects of the notified transaction, the Commission is under an obligation to clear the transaction. The Advocate General based this conclusion on the fact that the Merger Regulation provides that any transaction is deemed to be cleared if the Commission fails to make a decision within the time limits prescribed in the Merger Regulation, and that Article 82 allows for *ex-post* control of the combined entity.[7] The ECJ did not embrace the theory, but it also chose to leave the Advocate General's opinion as persuasive authority for future "grey zone" evidentiary cases.

While there is uncertainty as to how an "illegality defense" will be incorporated in the analysis, the ECJ's acceptance of behavioral commitments may make this a moot question for all practical purposes, because merging parties may incorporate the legal standards into their commitments.

Illegality of Alleged Leveraging Conduct

According to the CFI's judgment, the Commission was required to consider whether a company's incentive to engage in leveraging practices may be "reduced, or even eliminated, owing to the illegality of the conduct in question, the likelihood of its detection, action taken by the competent authorities, both at Community and national level, and the financial penalties which could ensue" (CFI judgment, para. 159).

The ECJ agreed with the CFI insofar as it required the Commission to examine the likelihood of leveraging comprehensively, taking into account both the relevant incentives and disincentives for such conduct. The ECJ also viewed the "possibility that the conduct is unlawful" as a relevant disincentive (para. 74). However, it then held that "it would run counter to the [Merger] Regulation's purpose of prevention" to require the Commission to engage in the kind of "exhaustive and detailed examination of the rules of various legal orders [...] and of the enforcement policy practiced in them." The ECJ viewed such an assessment as "too speculative" and to require it "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" (para. 77).

The implications of the ECJ's pronouncements are not entirely clear, in particular because the ECJ did not spell out the legal or practical objections to the CFI's test. The judgment does not appear to be saying that the unlawfulness of the stipulated leveraging conduct is irrelevant. Indeed, the judgment could be read as suggesting that where there is a high probability that the stipulated conduct constitutes an infringement of Article 82 or that the illegal conduct is essential for leveraging to occur, the Commission should take this into account.[8] While there is uncertainty as to how an "illegality defense" will be incorporated in the analysis, the ECJ's acceptance of behavioral commitments (discussed below) may make this a moot question for all practical purposes, because merging parties may incorporate the legal standards into their commitments.

Behavioral Remedies

During the administrative proceedings, Tetra Laval had offered a set of commitments, some of which were behavioral in nature. In particular, Tetra Laval had confirmed its pre-existing pricing commitments from the *Tetra Pak II* Article 82 case and committed not to bundle Tetra Pak's carton packaging products and Sidel's SBM machines. According to the Commission–which had quickly dismissed Tetra Laval's commitments in the administrative proceedings–such commitments amounted to little more than a promise to refrain from engaging in illegal conduct and were

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7. Opinion of AG Tizzano, paras. 75-81.

8. "Moreover, if it is to be relevant, such an assessment calls for a high probability of the occurrence of the acts envisaged as capable of giving rise to objections on the ground that they are part of anti-competitive conduct" (para. 76).

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therefore insufficient under the principles established in the *Gencor* case.[9]

The ECJ distinguished the facts at stake in the *Tetra Laval* case from those that had led to the CFI's dismissal of behavioral-type commitments in *Gencor*. Contrary to *Gencor*, in *Tetra Laval* the creation of dominance in the SBM market would only take place as a result of leveraging Tetra Laval's power on the neighboring carton market, in particular through abusive conduct. In the ECJ's view, in this type of scenario where structural changes will only be brought about after some conduct has taken place, commitments relating to the merged entity's future conduct may prove an adequate remedy for preventing such conduct from occurring in the first place. On that basis, the ECJ upheld the CFI's finding that the Commission's straight rejection, "as a matter of principle", of behavioral remedies could not be sustained.

The ECJ's judgment thus confirmed that well-crafted behavioral remedies may validly serve to alleviate the Commission's concerns in conglomerate cases. In fact, in a scenario such as that presented in the *Tetra Laval* case, a behavioral commitment may be the only effective remedy that is available, because the structural effects of an operation will only be perceived in the future, after (possibly anti-competitive) conduct has taken place.

Conclusion

The ECJ's *Tetra Laval* judgment is the most significant clarification of EC merger review since *Gencor*. In conjunction with the CFI's judgment, the ECJ's judgment provides a tighter (and more coherent) framework for the analysis of all mergers, but particularly conglomerate mergers. The requirement that the Commission consider the possibility that the behavioral remedies offered by the merging parties may be sufficient to alleviate the Commission's anti-competitive concerns is a welcome development. This and other holdings in *Tetra Laval* may be an important pre-cursor for the CFI's review of the pending *GE/Honeywell* case, where similar issues have been raised.

The ECJ's judgment also has broader implications, including as to the allocation of functions between the Commission as an administrative body and the Community Courts as a review body. The ECJ's judgment is an important reminder that the Community Courts will be ready to vigorously scrutinize the Commission's assessment of mergers in light of the evidence that has been adduced.

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Please contact any of us if you have any questions about these developments.

Berlin:

Ulrich Quack
ulrich.quack@wilmerhale.com

Boston:

James C. Burling
james.burling@wilmerhale.com

Brussels:

Claus-Dieter Ehlermann
claus-dieter.ehlermann@wilmerhale.com

John Ratliff
john.ratliff@wilmerhale.com

London:

Suyong Kim
suyong.kim@wilmerhale.com

Washington:

Douglas Melamed
doug.melamed@wilmerhale.com

William J. Kolasky
william.kolasky@wilmerhale.com

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9. Case T-102/96, *Gencor v. Commission*, judgment of 25 March 1999, 1999 ECR II-753.

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