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OPINION

EU-US judicial review of mergers

The Sony/BMG *and* Whole Foods/Wild Oats *cases*

by Catriona Hatton and Janet McDavid*

Two recent court decisions in the EU and the US on mergers have overturned lower court decisions adverse to antitrust agencies. In July, the European Court of Justice ruled that the Court of First Instance erred when it overturned the European Commission's approval of a joint venture between Sony Corp and Bertelsmann Music Group (BMG). In the same month, the US Circuit Court of Appeals for the District of Columbia ruled that the trial court erred when it denied the Federal Trade Commission's request to ban the merger of Whole Foods Market Inc and Wild Oats Markets Inc. These decisions may strengthen the hand of the antitrust agencies in assessing mergers.

The ECJ's decision in *Sony/BMG*

In July, the ECJ set aside the 2006 judgment of the CFI, which had annulled the European Commission's 2004 approval of the Sony/BMG music joint venture. In December 2004, Impala (an association of independent music production companies) appealed the approval decision to the CFI. In July 2006, the CFI overturned the Commission's decision, marking the first time the court had annulled a merger clearance. Sony/BMG appealed to the ECJ. The ECJ concluded that the CFI had committed "a number of errors of law in its judgment".

The European Court's decision is helpful in clarifying the burden of proof on the Commission in merger cases, the procedure to be followed by the Commission and the procedural rights of merging parties. Most importantly, it confirms that the Commission's statement of objections (SO) is only provisional in character.

The ECJ held that the CFI had erred in treating certain conclusions set out in the SO as being established. The ECJ held that the Commission is not required to maintain the factual or legal assessments set out in the SO in its ultimate decision, nor does it have to explain the differences between the SO and its final decision on the merger.

The ECJ also found that the CFI had made a mistake in requiring that the Commission apply particularly demanding requirements to the evidence and

arguments put forward by the parties in response to the SO. The ECJ confirmed that merging parties' evidence can be relied on by the Commission and should not be subject to more exacting standards than those used to evaluate the arguments of competitors, customers and other third parties.

Since the CFI decision, the Commission has avoided issuing an SO in some complex merger cases in order to avoid inconsistency between the SO and the final decision. The Commission has also subjected parties to burdensome requests for information to meet the exacting standard from the CFI's decision in *Sony/BMG*.

These clarifications from the European Court of Justice should facilitate the Commission's assessment of mergers within the relatively tight timeframe set out by the EC Merger Regulation and relieve some of the burden on merging parties.

Finally, the ECJ also confirmed the criteria for establishing collective dominance set out in the CFI's decision in *Airtours*. The main criteria are essentially as follows: sufficient market transparency so that companies can monitor whether others are "deviating"; a tacit collusion that must be sustainable over time, which means that there must be a credible threat of retaliatory measures to deter participants from "cheating"; and the inability of third parties to jeopardise that collusion. However, the ECJ found that the CFI had misconstrued the legal criteria on collective dominance, and it confirmed that these criteria cannot be applied in an isolated and abstract manner.

While the ECJ's decision is helpful to the Commission – and ultimately to companies who are subject to EC merger review – this particular case also highlights the inefficiency of judicial review of merger cases in the European Union. The ECJ did not consider itself in a position to give a ruling on the dispute since the CFI had examined only two of the five pleas made by Impala. The ECJ has therefore referred the case back to the CFI to assess again Impala's appeal against the original 2004 Commission approval decision. Meanwhile, Impala has appealed the second clearance decision adopted in 2007 by the European Commission to the CFI.

Just over four and a half years have passed since Sony and Bertelsmann notified their proposed joint venture for the first time. It has now been operating for several years and has been through two in-depth European Commission reviews and received two European Commission approvals. The fact that these approvals are still bogged down in lengthy appeals before the European Courts serves to highlight yet again that, despite some improvements over the last few years, the process for judicial review of EC merger decisions is still in need of broader reform.

FTC victory in *Whole Foods/Wild Oats*

Meanwhile also in July this year, a US court (the DC Circuit) overturned a lower court ruling that had permitted the merger of the two organic grocery store chains, Whole Foods and Wild Oats. The decision in *FTC v Whole Foods Market Inc* now jeopardises the merger, which closed almost a year before this decision.

Following the announcement of the merger, the FTC assessed the competitive effects on the basis of its impact on the market for premium, natural and organic supermarkets (PNOS). It sought to ban the merger in 2007 on the basis that the parties were the two largest chains in this market and the merger would stifle competition and violate section 7 of the Clayton Antitrust Act.

In August 2007, a federal district court rejected the FTC's argument that there was a narrow PNOS market. The court found that Whole Foods and Wild Oats also faced competition from more conventional supermarkets. Since the two retailers had negligible power in this broader market, the district court reasoned that a merger between them would not substantially lessen competition. On 28 August 2007, one week after the district court's decision, Whole Foods and Wild Oats consummated their merger.

The FTC appealed the decision to the DC Circuit which began by affirming the standard of review in cases in which the FTC seeks a preliminary injunction. Under section 13(b) of the Federal Trade Commission Act, 15 USC 53(b), a district court may grant preliminary relief "[upon] a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest."

The district court declined to consider the equities because it found that the FTC had failed to show any likelihood of success. In an opinion by Judge Janice Rogers Brown, the DC Circuit stated that a preliminary injunction is appropriate if the FTC raises "questions going to the merits so serious, substantial, difficult, and doubtful as to make them fair ground for thorough investigation". If it meets this standard, the FTC is entitled to a presumption against the merger on the merits, and need not present "detailed evidence of anticompetitive effect at this preliminary phase".

At both the trial and appellate court levels, the case turned on the definition of the relevant product market. Whole Foods and the district court focused their attention on Whole Foods' marginal customers. Whole Foods argued that these customers would not remain loyal in response to a price increase by the grocery store chain, and already "cross-shopped" with more traditional supermarkets such as Safeway Inc. Therefore, conventional grocery retailers were in the same market as PNOS retailers and the merger between Whole Foods and Wild Oats would not be anticompetitive.

The DC Circuit held that the district court incorrectly analysed the product market by focusing only on the marginal customer, rather than the “core” or “committed” customer. The DC Circuit held that a “core consumer can, in appropriate circumstances, [also] be worthy of antitrust protection”. According to the court, the FTC's evidence demonstrated that there existed a distinct PNOS submarket that catered to core customers who “have decided that nature and organic is important, lifestyle of health and ecological sustainability is important.”

The court also found that the FTC’s evidence indicated that Whole Foods and Wild Oats competed with traditional supermarkets “only on the dry grocery items that were the fringes of their business” and not in high-quality perishables that represent 70% of Whole Foods' revenue. This “fringe competition” for marginal customers would not protect the core customers who needed the “whole package” from Whole Foods. Since the district court failed to address these core customers, the DC Circuit disagreed with the district court’s conclusion that “the FTC would never be able to prove a submarket”.

The DC Circuit remanded the case to the district court “for proceedings consistent with this opinion”. If the district court now decides that a preliminary injunction is appropriate, there is a serious question about the form it would take, particularly since a number of Wild Oats stores have already been sold or closed in the meantime.

If some injunctive remedy can be found, the FTC has already announced that it will conduct an administrative trial, with a commissioner sitting as trial judge, and there will be additional evidence of “post-merger” events, and perhaps new theories of liability or defence offered by the parties.

Despite uncertainties about the ultimate fate of the Whole Foods/Wild Oats combination, the present decision is a significant victory for the FTC, one which should make it easier for the agency to get preliminary relief against proposed mergers in the future. But it raises concerns because a different (and higher) standard applies to preliminary injunctions sought by the antitrust division of the Department of Justice. The different standards between the two agencies are likely to be controversial.

*** Catriona Hatton and Janet McDavid are partners in Hogan & Hartson LLP (Brussels) and (Washington DC) respectively**