OPINION

The European Court of First Instance Rules in Favour of Compensation for Illegal Prohibition of a Merger by the European Commission in *Schneider/Legrand*

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On 11 July 2007, the European Court of First Instance ('the CFI') delivered its long-awaited judgment in the appeal of Schneider Electric SA ('Schneider')[1] against the decision of the European Commission ('the Commission'). The CFI ruled for the first time that a merging party can be compensated (at least in part) for losses sustained as a result of the illegal prohibition of its merger.

Background

In February 2001, Schneider and Legrand, two large French industrial groups, agreed that Schneider would acquire control of Legrand through a transaction that required clearance by the Commission.

Subsequent to Schneider's acquisition of Legrand in August 2001, the Commission blocked the merger on the grounds, *inter alia*, that the merged entity would significantly impede effective competition in a number of markets in France. These include the electrical panel-board components sector and various downstream electrical equipment market segments. The Commission also adopted a separate decision ordering the divestment by Schneider of Legrand. Schneider subsequently brought an action for the annulment of both Commission decisions. At the same time, Schneider prepared its divestiture of Legrand.

By its judgments of 22 October 2002, the CFI annulled the Commission's prohibition decision.[2] The court held that the Commission had failed to have regard to Schneider's rights of defence, since the Commission had advanced for the first time in the decision an objection to the merger that Schneider had not had an opportunity to comment upon. The objection alleged that Schneider would leverage its dominant position in the electrical panel-board components sector into Legrand's leading position in downstream electrical equipment market segments in France. According to the court, the alleged reinforcement of a dominant position through the dominant firm's position in related markets (facilitated by its ability to provide a portfolio of products) had not been raised in the Statement of Objections earlier in the proceedings. Accordingly, the Commission had not afforded the merging parties the opportunity to counter such allegations, nor to craft remedies that could address the Commission's concerns arising from the 'portfolio' effect created by the merger.

The Commission, however, had not closed its procedure until after the date on which the sale of Legrand had been contractually agreed to take place. This led Schneider to divest Legrand.

Subsequently, Schneider brought an action for damages before the CFI, with the aim of obtaining compensation for the loss which it claimed to have suffered from the divestment and as a result of the alleged illegality of the prohibition decision as found by the court.

The judgment

The court pointed out that, for the Community to incur non-contractual liability, there must have been unlawful conduct on the part of the Community's institutions, with the standard of review being whether there was a grave and manifest disregard of the limits of their powers of assessment. Such a manifest disregard of powers will occur where the acts or omissions of the Commission which cause damage cannot be explained by the 'objective constraints' of the merger control procedure. In other words, the Commission is allowed some margin of manoeuvre in its dealings with the notifying parties, but only insofar as its actions are justified or explained by the time constraints of the market analysis procedure or by any technical problem arising from that analysis which would require additional scrutiny.

The CFI found that there had been such an infringement of Schneider's rights of defence on the facts, as the Commission's Statement of Objections had not allowed Schneider to adequately assess the Commission's competition concerns, in particular with regard to the issue of the leveraging of dominance in certain related national markets. This had deprived Schneider of the possibility of offering

1 Case T-351/03.

2 See also *Airtours/First Choice*, *MCI WorldCom/Sprint* and *Tetra Laval/Sidel* cases, where flaws in the Commission's reasoning and serious procedural errors led the CFI to annul the Commission's merger prohibition decisions.

appropriate remedies that were capable of reducing or eliminating the Commission's competition concerns.

There was no objective justification or explanation put forward by the Commission for this infringement of the rights of defence. The court therefore concluded that the illegality, whose existence and character were not disputed by the Commission, resulted in an obligation on the Commission to compensate for the harmful consequences of that illegality. In doing so, the CFI was careful to point out that it is only errors which go beyond those that can be expected by an administration performing its ordinary tasks that can give rise to a right to compensation. For example, the court reiterated that the Commission shall be afforded some latitude in its forward-looking analysis and in its interpretation of complex economic data, and that the logical and consistent application of sound economic theory (even if not universally followed in all cases) should not be susceptible to a successful action for damages (even if the appellant suffers harm).

The court went on to hold that, on the facts, the illegality vitiated the Commission's decision of incompatibility, thereby conferring upon Schneider a right to compensation in respect of:

- expenses incurred by Schneider relating to its participation in the resumed merger control procedure which was undertaken by the Commission following the annulments pronounced by the court on 22 October 2002, and
- the reduction in the divestiture price which Schneider had to concede to the purchasers in order to obtain a postponement of the execution of that divestiture (whilst it was trying to obtain the annulment of the Commission's prohibition decision).[3]

Importance of the judgment

Although this was unprecedented, there had always been a theoretical possibility that damages could be available in limited circumstances for an aggrieved merging party where the Commission's decision to block a merger was fundamentally flawed. The issue that had remained unresolved since the inception of the Merger Regulation, however, was the extent to which this principle of non-contractual liability could be invoked in practice, given the existence of a certain margin of discretion of the Commission in its interpretation of economic evidence.

By clearly identifying the threshold at which point the Community incurs non-contractual liability for unlawful conduct as a situation where there was a 'grave and manifest' disregard of the limits of the authority's powers of assessment, the CFI has paved the way for damages actions to be brought against the Commission by undertakings which consider themselves aggrieved by the Commission's handling of merger control proceedings. These serious procedural errors can serve as the basis for an action for damages, but such an action based on an alleged faulty assessment (that is, a substantive assessment) might prove as elusive as ever, despite the willingness of the CFI to subject the economic analysis of the Commission to intense scrutiny.[4]

In addition, the court has focused on the importance in the Commission's merger review procedure of the scope of a Statement of Objections, which needs to set forth clearly the types of anti-competitive concerns which the Commission has in connection with the notified merger. This position is consistent with the importance attached to the Statement of Objections by the CFI in its judgment in *Impala*, insofar as the Commission was judged to have materially and therefore illegally departed from its Statement of Objections in its final decision. This will probably have the unintended consequence that the Commission will be tempted, at least in those merger cases that might be problematic from an antitrust prospective, to extend the length of merger pre-notification discussions so that it is in a better position to articulate its position in the Statement of Objections where it might harbour 'serious doubts' about the notified merger.

Finally, it should be made clear that the effect of the judgment does not open the floodgates to appellants wishing to argue that the quantum of damages in any given merger case should approximate to the total value of the deal lost to the acquirer. On the contrary, the CFI is keen to explore the causal nexus between the allegedly illegal behaviour of the Commission and the damage actually suffered. For example:

- the loss suffered through the failure to realise post-merger synergies, or anticipated profits, was excluded by the CFI (namely, there is no compensation merely because the merger might have received clearance);
- the loss incurred by Schneider for divesting the Legrand business was rejected because

3 As to that second type of loss, the CFI ruled that, in this specific case, only two-thirds of that loss should be compensated, since Schneider had itself contributed to its own loss by assuming the real risk that the merger would subsequently be declared incompatible, and that the resale of the shareholding in Legrand would be the inevitable consequence of assuming such a risk.

4 For example, see the CFI's review of Commission Decisions in cases such as *Impala*, *Airtours*, *Tetra Laval*.

the illegality of the Commission decision did *not*, in the view of the court, necessarily mean that the merger was compatible with the Common Market;

- it would, however, be reasonable to claim damages for the reduction in the divestiture price occasioned by the fact that the divestiture was postponed pending the rulings by the court.

The precise quantum of damages remains to be calculated after the court has received expert testimony. Moreover, there also remains the more complex issue of the legal standard to be applied where the Commission has erred in its substantive analysis – in other words, under what circumstances the court will be prepared to consider that the Commission has exceeded its margin of discretion in interpreting economic data, and has thereby committed a 'grave and manifest' error of judgement. That issue will fall to be decided in the pending *My Travel* appeal before the court. Given the fundamental restructuring of the travel industry that has occurred recently in a series of mergers blessed by the Commission under the Merger Regulation, the views of the CFI as regards the quality of the Commission's forward-looking economic analysis could not come at a more inconvenient time for the Commission.