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Another Commission Merger Decision Overturned by CFI.

Introduction.

On 13th July the Court of First Instance overturned a Commission decision approving a proposed merger of the global recorded music businesses of Bertelsmann AG ('Bertelsmann') and Sony Corporation of America ('Sony'), part of the Sony Group. The Commission had originally issued a statement of objections but, following further submissions and a hearing with the parties, it approved the merger. The decision was appealed by the Independent Music Publishers and Labels Association (Impala). Impala is an international association, incorporated under Belgian law, whose members are 2 500 independent music production companies. As in *Airtours*[1] the Court was strongly critical of the Commission.

Overview of the Judgment

In *Airtours* the Court set out the conditions which had to be met in order to show that a merger would result in the creation of a collective dominant position. In particular it stated that the market would need to be sufficiently transparent to enable firms to detect any deviation from the collusive outcome and that an effective retaliatory mechanism must exist to punish such deviations.

In this latest case the Court noted that the Commission had concluded in its statement of objections that a collective dominant position already existed before the proposed concentration and that the market for recorded music was transparent and particularly conducive to coordinated behaviour.[2] The Court noted that it was accepted by both sides that the Commission decision to change its view regarding the prior existence of a collective dominant position in the music market was based solely on a finding that the market lacked the degree of transparency necessary for coordinated behaviour. Thus the bulk of the Court's judgment was concerned with whether such a conclusion was justified by the facts.

The Commission, in its final Decision, had concluded that while list prices and certain types of discounts were transparent, there was a lack of transparency in respect of "campaign" discounts. The Commission concluded that, although there was considerable transparency in respect of many other aspects of prices, the lack of transparency in relation to "campaign" discounts meant, according to the Commission, that overall there was insufficient transparency to justify a finding that a collective dominant position already existed which would be strengthened by the merger. The Court found that such a conclusion was not supported by the facts.

The Court referred to the fact that the section of the Commission Decision on transparency was limited to just three paragraphs although this was "the essential, and indeed the only, ground for the assertion that there is no collective dominant position on the markets for recorded music." The Court pointed out that, in its analysis of transparency, the Commission had not concluded that the market was not transparent, or even that it was not sufficiently transparent to permit tacit collusion. It went on to observe:

> "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."[3]

The Court noted that apart from two extracts, all of the factors set out in the section of the Decision dealing with transparency, "far from demonstrating the opacity of the market show, on the contrary, that the market was transparent."[4] It then went on to state:

> "It follows from the foregoing that the assessment of the transparency of the market made in the Decision is vitiated by a manifest error in so far as it relies on elements which are not capable of supporting the conclusions drawn from them."[5]

The Court concluded that on this ground alone, the Decision should be annulled.

Having found that the Commission had erred in finding that a collective dominant position did not already exist in the music industry, the Court also criticised the Commission for failing to carry out a prospective analysis of whether, as a result of the merger, a collective dominant position would be created. Commenting on the Decision's findings on this point, the Court observed:

> "It must be stated that these few observations, which are so superficial, indeed purely formal, cannot satisfy the Commission's obligation to carry out a prospective analysis and to examine carefully circumstances which, according to each particular case, may prove relevant for the purposes of assessing the effects of the concentration on competition in the reference market, particularly where, as in the present case, the concentration raises serious problems."[6]

The Court went on to state that a thorough forward looking examination was required given the fact that:

(i) the Commission had to engage in lengthy discussion in the Decision in order to conclude that there was no collective dominant position before the concentration; and

(ii) the fact that it had concluded in the statement of objections, after an investigation lasting five months, that

> such a position already existed before the concentration.

The Court concluded that the Commission's failure to carry out such an examination meant that, on that ground alone, the Decision should be annulled.

The Court also expressed some criticism of the stance adopted by the Commission during the appeal.

> "As regards the Commission, it is a matter for regret that, on a number of points, its observations depart, sometimes quite appreciably, from the analyses made in the Decision, with the consequence that the applicant and the Court were constantly obliged to make abnormal checks."[7]

Comment.

Not for the first time the CFI has been strongly critical of the Commission for failing to conduct a proper analysis of a proposed merger. In language that echoes earlier judgments such as *Airtours,* the Court found that "the Commission's decision was "vitiated by, first, inadequate reasoning and, second, a manifest error of assessment in so far as the elements forming the basis of the Decision do not constitute all the relevant data that must be taken into consideration and are not sufficient to support the conclusions drawn from them."[8] Such strong criticisms illustrate the need for an effective system of checks on decisions of regulatory bodies.

It is also worth highlighting the fact that, in this instance the appeal was by a third party objecting to a Commission Decision to clear a proposed merger. In Ireland third parties do not have a right to appeal decisions by the Competition Authority approving mergers, a point that is considered in the following article.

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[1] *Airtours plc v. Commission,* case T-342/99, judgment of 6 June 2002.
[2] Para 282
[3] Para 289
[4] Para 290
[5] Para 390
[6] Para 528
[7] Para 553
[8] Para 542

Government Seeks Views on Regulatory Appeals.

Introduction.

The Department of the Taoiseach last week published a consultation paper in relation to appeals against decisions by regulatory agencies. The document is relatively brief, just 49 pages, for a topic that is both complex and of major importance. The publication of the Consultation Document stems from a commitment contained in the Government's January 2004 White Paper, *Regulating Better,* to consult with interested parties in developing proposals for an improved approach to appeals mechanisms for regulatory decisions. Interested parties have until 31st October to respond with their comments.

The consultation document was produced by a group comprising individuals from various regulatory agencies along with officials of certain Government departments. Such an exercise would surely have benefited from the inclusion of some representatives of firms operating in regulated industries along with lawyers and other advisers with direct experience of regulatory appeals.

The document states that the Group's main focus was on appeals of decisions of the various economic and sectoral regulatory authorities, namely:

1. The Commission for Communications Regulation (ComReg);
2. The Commission for Aviation Regulation (CAR);
3. The Commission for Energy Regulation (CER);
4. The Financial Regulator;
5. The Competition Authority; and
6. The Commission for Taxi Regulation.

Main Points.

Section 2 of the Consultation Document describes the existing mechanisms for appealing decisions of the regulatory bodies listed above. Section 3 provides a brief description of the regulatory regimes that operate in the UK and Australia along with an outline of the key points of a report on national appeals procedures for the electronic communications sector produced by the International Regulators Group (IRG). The Consultation Paper then considers certain aspects of appeals in Section 4.

Currently a wide variety of mechanisms exist to appeal regulatory decisions while there are also wide differences in relation to the type of decisions that can be appealed. In the case of the CER, for example, the right to appeal is limited to a determination of a network dispute between the operator of the transmission system and a user of the network and decisions regarding licences to generate electricity and authorisations to build power plants. In the case of the aviation regulator, customers, i.e. the airlines, can specifically appeal decisions in respect of price caps for airport charges and terminal services. In addition to the appeals mechanisms established under statute for the various regulatory agencies, regulatory decisions are subject to a general appeal by way of judicial review.

Among the issues considered in Section 4 of the document are:

1. Whether appeals should be dealt with by a court or a specialist body;
2. Whether they should be dealt with by a specialist court, possibly with lay assessors;
3. Whether there should be a single appeals body;
4. The scope of appeals;
5. Time limits; and
6. The powers of appeal bodies.

What is the Objective?

A serious weakness in the paper is its failure to address the issue on the basis of first principles. The paper fails to identify what is the ultimate aim of an appeals process.

Economic regulation, by which we mean, regulatory regimes for regulating public utility industries, such as electricity, gas, and telecommunications, is designed to address two basic issues:

- Part of the industry may constitute a natural monopoly or essential facility and the owner of such a facility may obviously seek to take advantage of this by charging excessive prices for use of the facility. This problem is compounded where the owner of such facilities also competes in the downstream market since it has an obvious incentive to deny access to the network.

- Firms in such industries may have a dominant position, in some cases as a result of having previously enjoyed a statutory monopoly. Firms may abuse such a position by charging excessive prices to consumers. In the latter case, economists generally argue that regulation may be required as a temporary measure, pending the establishment of a competitive market structure.

The economics literature over the last forty years has highlighted the fact that regulation is subject to serious imperfections. In particular, regulators do not have as much information as the firms they are regulating. This tends to make them heavily dependent on those firms, which leaves them particularly vulnerable to "regulatory capture". A second problem is that regulators are prone to favour increased regulatory intervention regardless of whether or not such interventions represent an effective solution. Incorrect regulatory decisions can impose massive costs on consumers and the economy as they result in higher costs to consumers and businesses. In the case of economic regulation, therefore, some mechanism is required as a check against the potential for regulators to make wrong decisions and to expand their activities unnecessarily.

The issue is what form of appeals mechanism is appropriate to deal with the potential for failure of economic regulation. Economic regulation is extremely complex and requires a degree of specialist knowledge. This would tend to suggest that such appeals should be dealt with by a specialist body rather than by the courts. It would also favour a system of appeals on the merits, i.e. one where the appeals body would be empowered to embark on a complete review of the regulator's decision and to substitute its own decision for that of the regulator.

A major problem with the Consultation Document is that, while it states that it is concerned with economic regulation, many of the issues addressed are not concerned with such regulation. For example, one of the arguments advanced against having a single appeals body is the disparate nature of the functions of regulatory agencies from the licensing of travel agents to the building of power stations. Such arguments appear to miss a fundamental point. The licensing of travel agents does not involve economic regulation.

Consider the example of the taxi regulator. The grant of a licence to an individual to drive a taxi and a decision setting fares for taxis are quite distinct in nature and their effects. In the former case an appeal mechanism is necessary to ensure that the particular individual has been fairly treated. In the latter case an appeal mechanism is necessary to ensure that the interests of the industry and, more importantly because they are often overlooked, of consumers have been properly taken into account. A mechanism for appealing the regulator's decision on taxi fares might also have averted the recent protect action by taxi drivers who currently have no mechanism, other than judicial review, for an independent review of the regulator's recent decision on fares.

Such different types of appeal require different skills, expertise and processes. On the other hand certain common principles apply to the economic regulation of different utility industries. In other words, rather than being an argument for having separate appeals bodies for each regulator, the diversity of issues dealt with by regulators suggests that a different regime may be required to consider appeals of "economic" and "non-economic" regulatory decisions.

The paper also advances an argument, which has been trotted out by regulatory agencies in the past, that if an appellate body is empowered to undertake a full review and substitute its decision for that of the regulator, then this undermines the regulator and makes the appeals body the effective regulator. Such arguments appear disingenuous. Regulators are not omniscient. They can and do make wrong decisions. The nature of the industries that are subject to economic regulation mean that wrong decisions are very costly for the economy and society. Consequently some safeguard is required against such errors. Subjecting regulators' decisions to independent review provides a strong incentive for regulators to get it right.

Third Party Appeals for Mergers?

An issue which is not addressed in the document, but one which is particularly topical in light of the CFI judgment referred to in the previous article, is whether third parties should have a right to appeal merger decisions. Currently only the merging parties have a right to appeal. In the case of mergers two types of error are possible. The Authority might prohibit a merger which is not anti-competitive or alternatively permit a merger which is anti-competitive. In effect only the first type of error can be appealed. Merger controls exist to prevent mergers that reduce competition, since such mergers make society worse off. It therefore seems strange that there is effectively no safeguard against this type of error. The Sony/BMG case illustrates that regulatory bodies can make such mistakes.

A Voice for Consumers?

The other main problem with the document is its failure to give any significant consideration to the role of consumers in the regulatory process. Theoretically regulators are there to protect consumers against firms abusing their market power. The fact that regulatory bodies are prone to capture means that they may fail to discharge this role. With the exception of the CAR, customers have no right of appeal against price increases sanctioned by regulators. This is compounded by the disadvantage that individual customers and small firms face in trying to counter regulated firms' ability to devote considerable resources to support their arguments for higher prices. The newly established National Consumer Agency should have the right to appeal price increase decisions.

Conclusions.

Up to now appeals mechanisms have been put in place on an ad-hoc basis for individual regulators. Consequently a review of the issue of appeals of regulators' decisions is welcome. The complex issues and questions involved arguably deserve a far more detailed analysis than is provided in the brief consultation document. A useful starting point would be to ask what is the objective of such an appeals process?

Authority Loses BIDS High Court Action.

Introduction.

Last Thursday (27th July) the High Court ruled against the Competition Authority in respect of arrangements involving a number of beef processing plants which were members of the Beef Industry Development Society (BIDS). The arrangements involved a rationalisation plan whereby firms that exited the industry and who agreed to decommission their plants for a five year period would be paid by those firms remaining in the industry. Mr. Justice McKechnie found that the Authority had failed to produce credible evidence to show that the agreement, if implemented would prevent, restrict or distort competition and ultimately harm consumers through higher beef prices.

Background to the Case.

The action arose following the establishment of BIDS in May 2002. BIDS argued that the beef processing industry was facing severe overcapacity problems and that a rationalisation of the industry was required. It further argued that such a rationalisation could only be achieved through a co-operative approach.

The firms involved in BIDS operate larger abattoirs which are licensed to export beef. Most of the beef processed in such plants is exported with only a relatively small proportion of their output sold on the domestic market. There are a large number of smaller abattoirs which supply the domestic market, although the number of such premises has fallen in recent years.

According to the Authority, BIDS had reached an agreement for a 25% reduction in beef slaughtering capacity. This was to be achieved by means of an arrangement whereby those firms which closed plants would be compensated by those remaining in the industry. These payments were to be financed by means of levies to be paid for each animal slaughtered by those firms remaining.

Economic Analysis.

An unusual feature of the beef processing business is the fact that the vast bulk of production is exported. For example, CSO figures for 2004 show that a total of 1.8m cattle and calves were slaughtered in that year, with 1.7m of the total being for export. Many of the plants which supply the domestic market are relatively small. In many instances individual butchers operate their own abattoirs. In addition, evidence before the court indicated that up to 25% of domestic consumption was accounted for by imports.

In the circumstances, questions obviously arise as to whether BIDS could successfully raise prices. It is difficult to see how they could do so, given that most of their output is sold on international markets where they could hardly be said to have market power. Similarly their limited domestic sales suggest they could not have affected prices to domestic consumers. The judge also concluded that, while there may be significant barriers to de novo entry in the industry, entry was possible as non-export plants could be acquired and upgraded to export standard and there have been examples of this in recent years.

Whether the arrangements could increase beef processors' buying power, thereby enabling them to force down the price paid to farmers may be a different issue, although, interestingly, this does not appear to have featured in the case to any significant extent.

The judge expressed some criticisms of the economic evidence presented by both sides. He also indicated that BIDS had not established that cost savings arising from the arrangements would be passed on to consumers. The implication is that had the Authority succeeded in establishing that the arrangements were anti-competitive, the court would have found that they did not satisfy all the criteria necessary for exemption.

Conclusions.

The verdict is obviously something of a setback for the Authority. While the arrangements involved a degree of coordination and were designed to reduce the number of market participants, the court held that the Authority had nevertheless failed to show that they were anti-competitive. This appears to have been due to the particular circumstances which prevailed in the industry rather than an indication that such arrangements of their nature are unlikely to fall foul of competition law.
