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Schneider Electric v Commission— The European Court of First Instance Breaks Ground In Relation To Damages In Merger Cases

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On July 11th, the European Court of First Instance ("CFI") for the first time ever awarded damages to a firm for the loss it suffered as a result of the European Commission's ("Commission") prohibition of a proposed merger that had been subsequently annulled by the CFI.[1]

In 2001 the Commission had blocked the attempt of a French company, Schneider Electric ("Schneider"), to acquire Legrand, a competing French manufacturer of electrical equipment. According to the CFI, the Commission's "grave and manifest failure" to have regard to Schneider's right to be heard on the objections raised over its proposed acquisition of Legrand was a sufficiently serious breach of EU law to confer on Schneider a right to claim compensation under Article 288 of the EU Treaty, the provision governing the non-contractual liability of the European Community.

The CFI's verdict follows the Commission's defeats in a series of merger appeal cases, including *Airtours/First Choice* [2], *Tetra Laval/Sidel*[3], *Schneider/Legrand*[4], and, more recently, *Sony/BMG*[5]. It is likely to contribute to the Commission being ever more cautious in making sure that its merger decisions are both procedurally and substantively sound and is a welcome sign that the CFI is not afraid to go hard against the Commission to protect companies' rights.

The judgment is groundbreaking as it clarifies, for the first time, the circumstances in which the Commission may be liable for damages as a result of errors in its assessment of mergers and in merger procedures. The CFI denied Schneider's damages claims based on errors the Commission had committed on the substantive assessment of the blocked acquisition, and in doing so once again recognised the broad discretion the Commission enjoys in complex merger cases. However, it did

1 T-351/03, *Schneider v Commission*, available at http://curia.europa.eu.

2 T-342/99, *Airtours v Commission*, ECR [2002] II-2585.

3 T-80/02, *Tetra/Laval v Commission*, ECR [2002] 4519.

4 T-310/01, *Schneider v Commission*, ECR [2002] II-4071.

5 T-464/04, *Impala v Commission*, (not yet reported in ECR, available at http://curia.europa.eu).

not exclude that a claim could be brought on such basis, given the right circumstances. Furthermore, the Court upheld Schneider's claim insofar as it related to damages arising from a breach of its procedural rights, explaining that the discretion the Commission enjoys and the complexity of merger cases cannot justify serious procedural deficiencies in a decision to block a proposed merger.

THE FACTS

In 2001, the Commission blocked the proposed merger of Schneider and Legrand, two French companies active in the electrical equipment sector, on the ground (amongst others) that the merger risked impeding effective competition in several product markets in France. Since the acquisition was to take place pursuant to a public tender offer and French law did not allow Schneider to suspend the transaction pending clearance by the Commission, Schneider had already purchased 98% of Legrand when the Commission adopted its prohibition decision. The Commission, therefore, in a second decision, ordered Schneider to divest all of its shares of Legrand. Schneider brought an action for annulment against both decisions, but in anticipation of the possible dismissal of its actions agreed in July of 2002 to sell its shares in Legrand to a third party, Wendel/KKR. Schneider agreed with Wendel/KKR that it would be able to walk away from the deal to divest its Legrand shares if it received a favourable ruling from the CFI. In addition, to allow time for the appeal, Schneider agreed with Wendel/KKR that completion of the sale would not take place before December 2002. In October 2002, the CFI annulled the Commission's decision and Schneider immediately sought to complete the transaction with Legrand, re-notifying the transaction to the Commission. Upon its reexamination of the transaction, the Commission again raised concerns over the transaction and opened an in-depth enquiry. In early December 2002, Schneider decided to abandon the acquisition of Legrand and eventually sold the shares to Wendel/KKR.

Schneider subsequently filed an action for damages before the CFI, claiming EUR 1.66 billion in compensation for losses it allegedly suffered as a result of the Commission's illegal prohibition of its acquisition of Legrand.

THE CFI RULING ON DAMAGES

A claim against the Community for non-contractual liability must satisfy a number of conditions. A damages claim must relate to the breach of a rule intended to grant rights to undertakings and the claimant must demonstrate a causal link between the error complained of and the loss suffered, including a demonstration that the claimant has not itself contributed to the loss. The decisive criterion for establishing that a breach of Community law is sufficiently serious to permit recovery of non-contractual damages is whether the Community institution concerned manifestly and gravely disregarded the limits of its discretionary power.[6]

The CFI's judgment first considers whether the substantive and procedural errors committed by the Commission in its prohibition decision can be a basis for the Commission's liability. The CFI then turns to the question of whether Schneider's claimed loss can be said to result from those errors.

THE ERRORS VITIATING THE COMMISSION'S DECISION

The CFI's decision notes under Court of Justice precedent that the non-contractual liability of the Community turns on, *inter alia*, the complexity of the situations to be regulated, difficulties in the application or interpretation of the legislation and, more particularly, the margin of discretion available to the author of the act in question in order to establish whether there has been a sufficiently serious breach of Community law.[7]

The Commission enjoys a wide margin of discretion when assessing proposed concentrations, in particular in relation to its forward-looking economic assessment. Furthermore, merger procedures are complex, difficult, and subject to significant time constraints. The CFI therefore recognized that certain errors committed by the Commission, such as an error of approximation, certain incoherencies or even omissions, will not give rise to

6 C-282/05 P, *Holcim (Deutschland) v Commission*, (not yet reported in ECR, available at http://curia.europa.eu), para. 47.

7 C-282/05 P, *Holcim (Deutschland) v Commission*, (not yet reported in ECR, available at http://curia.europa.eu), para. 115.

liability on the part of the Commission because to hold otherwise would jeopardize the effectiveness of merger control proceedings. Instead, the Commission will be liable for damages only where it can be demonstrated that it committed a grave and manifest error, for example by relying on inconsistent economic reasoning manifestly contrary to recognized economic theory.

The CFI had previously annulled the Commission's prohibition decisions on account of (i) failure in its substantive analysis of certain products markets in which Schneider and Legrand were active outside France, and (ii) failure to protect Schneider's right of defence in relation to its substantive concerns, otherwise justified, regarding the conglomerate effects of the proposed transaction in certain markets in France.

The CFI recognized that in its prohibition decision the Commission had committed certain errors of appreciation, in particular in relation to its analysis of the effect of the proposed transaction on markets outside France. But the CFI nevertheless concluded that these errors were not sufficiently serious to have changed the overall outcome of the Commission's decision. These errors therefore could not form the basis of a claim for damages.

With respect to the second ground of annulment, Schneider had successfully argued in its appeal that the Commission's concern that the transaction would lead to conglomerate effects in France had not been set out in its statement of objections[8]. Instead, the statement of objections had focused on the overlaps between the parties' activities in certain markets outside France. Because it was unaware of these concerns, Schneider had not been able to put together a sufficient package of remedies to seek to address the Commission's concerns in this respect.

The CFI found that the failure to give Schneider an opportunity to be heard on those concerns was sufficient to result in liability for the Commission. In particular, the EC Merger Regulation requires the Commission to give the undertakings concerned the opportunity to make known their views on the objections held against them at every stage of the procedure. The Commission may base its decision prohibiting a merger only on the objections to which the parties have been able to submit their observations. The Commission does not have any discretion in applying that rule, and failure to grant the parties the right to be heard cannot be justified by reason of either the complex or difficult nature of the assessment.

THE LOSS ELIGIBLE FOR COMPENSATION

Schneider had claimed compensation for loss allegedly suffered as a result of:

- the difference between the price at which it had purchased the Legrand shares in 2001 and the price at which it was able to sell those shares to Wendel/KKR in December 2002;
- the loss of a chance to have the merger cleared;
- lost synergies that might have resulted had the merger gone ahead;
- the negative impact on the reputation of Schneider; and
- legal and other fees as a result of the Commission's divestiture order, the Commission's re-examination of the acquisition following the CFI's annulment of the first decision, and judicial costs.

Schneider had argued that if it had known of the Commission's concerns of conglomerate effects in the French markets, it could have offered a divestment package that would have allowed the transaction to proceed. The CFI, however, rejected these claims on the basis that even in the absence of the failure to hear the parties, it was not certain that the transaction would have been cleared. The only effect of the failure to hear the parties was to put Schneider in a situation where it was unable to offer a satisfactory remedy package. The violation did not mean that the Commission's economic analysis of the French markets was in itself incorrect or that a satisfactory remedy would have been offered and accepted. Schneider had therefore failed to demonstrate the required causality between the infringement and the alleged loss.

8 The formal document in which the Commission explains its concerns about a proposed merger and gives the parties a right to reply.

As regards the other financial losses, however, the CFI upheld Schneider's claim in two respects:

- First, Schneider was entitled to recover the expenses it incurred as a result of its participation in the resumed merger control procedure undertaken by the Commission following the CFI's annulment of its first decision in October 2002.
- Second, Schneider was entitled to recover the reduction in price of Legrand shares it had been required to offer Wendel/KKR in order to postpone completion of that transaction pending the outcome of its appeal. However, the CFI held that because Schneider had contributed to that loss by taking on the real risk that the merger would also subsequently be declared incompatible, thus requiring the sale of its Legrand shares, only two-thirds of the loss should be compensated.

The CFI's decision requires the parties to agree and inform the CFI of the amount of the first category of loss within three months of the judgment. The second category of loss will be quantified by a CFI-appointed expert. Schneider had claimed damages in the amount of approximately EUR 1.66 billion, but it is unlikely to recover the full amount. According to a Commission spokesperson, the total amount due by the Commission is unlikely to exceed EUR 400 million.[9]

CONCLUSION

The CFI has clarified that errors and omissions in merger decisions may be justified by the broad margin of appreciation which the Commission enjoys in relation to complex economic assessments, and by constraints such as timing and the complexity of a matter. Serious errors of a procedural nature are, however, unlikely to be justified by such considerations and therefore appear more likely to be capable of supporting a claim for damages.

The CFI's judgment is a welcome, and necessary, complement to the willingness it has, demonstrated in a series of recent judgments overturning Commission merger decisions, to impose checks and balances on the Commission's decision-making processes in order to protect the rights of undertakings. It is clear from the judgment, however, that the broad discretion that the Commission enjoys in its substantive analysis of merger cases will often stand in the way of successful damages claims. It is only in the rare circumstance that a clear and serious breach of the Commission's obligation towards the undertakings concerned can be shown—such as a flagrant breach of the rights of defence—that such claim will be successful, in whole or in part.

9 Various press reports quoting European Commission Spokesperson for Competition, Jonathan Todd.

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