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January 29, 2019

EUROPE'S HIGHEST COURT FINDS IN FAVOR OF UPS IN MERGER REVIEW APPEAL

To Our Clients and Friends:

On 16 January 2019, the European Union's highest court, the Court of Justice, upheld the claim of United Parcel Service, Inc. ("**UPS**") that the European Commission ("**Commission**") had breached its rights of defense. It had breached those rights when it had declared that UPS's proposed merger in 2012 with TNT Express NV ("**TNT**") was incompatible with the internal market because it would lead to significant impediment of competition in up to 15 Member States of the European Economic Area.[1] The Court of Justice thus upheld a Judgment of the General Court taken in 2017.[2] Both UPS and TNT are leading providers of international express delivery of small parcels.

The violation of the UPS's rights of defense occurred when the Commission failed to provide UPS with the opportunity to comment upon a revised econometric model which served as the Commission's basis for prohibiting the proposed merger because of the supposed risk that prices would rise post-merger. In the circumstances of the case, that failure on the part of the Commission was sufficiently important to justify the conclusion that the Commission Decision adopted on 13 January 2013[3] should be annulled. The Court of Justice's Judgment is of high importance to merger practitioners both because of the confirmation of the procedural standard which the Commission needs to satisfy in its merger reviews, but also because of the possible ramifications which the Judgment might have on the procedures to be followed in future merger proceedings.

1. Background

In upholding UPS's action for annulment of the Commission's Decision nearly four (4) years after the filing of the appeal against the Commission's veto Decision in the proposed UPS/TNT merger, the General Court in Luxembourg ruled that the Commission had breached UPS's rights of defense by relying on a modified version of its initial econometric analysis without having shared that version with the merging parties before the Decision to block the merger was adopted.

The Commission appealed against the General Court's Judgment on three separate grounds, the first two of which related to an infringement of the rights of defense (and the consequences arising therefrom) and the third ground consisting of an alleged infringement of the obligation on the Commission to state reasons for its adopted Decisions.

2. Infringement of the rights of defense

The cornerstone of the Commission's challenge to the General Court Ruling lay in its denial that it was under an obligation to communicate the final econometric analysis to the merging parties before adopting its final decision.

In support of its position, the Commission expressed its view that, after a Statement of Objections ("**SO**") has been issued to the notifying parties, it is not obliged to disclose any interim or preliminary conclusions until the time of the adoption of its Decision, as its conclusions in the intervening period between a SO and the Decision might be subject to modification or change.[4] To this end, argued the Commission, the only findings that are challengeable are those that are contained in the final adopted Decision, even if one assumes that the Commission cannot rely on grounds of which the notifying parties are unaware.[5] Moreover, the Commission argued that the General Court had erred in implying that the Commission was under an obligation to disclose all of its internal views prior to the adoption of a Decision, as the right of access to the file does not extend to internal documents.[6] Finally, the Commission contended that, even if UPS's rights of defense had been infringed, this could not lead to an annulment of the Commission's Decision because – at least with respect to some of the markets – an impediment to competition had already been found based on factors other than the economic analysis.[7]

The Court of Justice commenced its Ruling with an affirmation that the right of defense is a general principle of EU law that must be observed. With respect to merger control review, the application of that general principle requires, among other things, that the Commission provide written notice to the notifying parties of the Commission's objections, and that this notice be accompanied by an appropriate period in which the notifying parties can address those objections in writing.[8] What this means in practice is that the notifying parties must be put in a position in which they can make known their views on the accuracy and relevance of all the factors upon which the Commission intends to base its Decision. To the extent that the Commission seeks to justify its position by reference to an econometric model, it follows that the parties must be able to submit their observations on that particular econometric model.

In the view of the Court, the fact that an SO only sets forth the Commission's provisional conclusions, which may legitimately be modified in light of observations received and evidence collected, does not entitle the Commission to amend its econometric model upon which its objections are based without having first communicated those amendments to the notifying parties.[9]

In light of the importance attributed by the Commission to econometric models in assessing the effects of a merger, the Commission's failure to disclose such information ran counter to the policy priority accorded to transparency in the merger review process. Such a practice would have the effect of undermining any effective judicial review of Commission Decisions by the Courts.[10] As such, the Court of Justice concluded that the General Court had not erred in law in holding that the Commission Decision should be annulled as a consequence of the infringement of UPS's rights of defense.[11]

3. The obligation on the General Court to state reasons

Finally, the Commission sought that the General Court's Ruling be overturned because the General Court had failed, in its view, to acknowledge formally a number of arguments raised by the Commission when responding to certain questions raised by the General Court at the hearing in Luxembourg. In the circumstances, argued the Commission, the General Court should be held to have failed to examine and address the arguments raised by the Commission.[12]

The Court of Justice rejected the Commission's arguments on this point, holding that the General Court had addressed the points put forward by the Commission, even if it had only done so implicitly.[13]

In particular, the Commission criticized the General Court for having failed to take formal note of an argument according to which the use in the econometric model of a continuous variable for the prediction stage was warranted and followed from UPS's methodology on estimation rate. The Court recalled that the General Court had noted that the Commission relied on a discrete variable at the estimation stage and on a continuous variable at the prediction stage, holding that although the use of a discrete variable had been discussed repeatedly during the administrative procedure, it did *not* appear from the file that it had also been the case with regard to the use of different variables at the different stages of the econometric analysis.[14] For those reasons, the Court considered that the General Court had justified in law its Ruling and had implicitly rejected the Commission's arguments that UPS had "intuitively" been able to identify the amendments to the econometric model.[15]

Lastly, the Commission also claimed that UPS's plea that its rights of defense had been infringed should have been dismissed by the General Court, because the finding of a significant impediment to effective competition on the respective Danish and Dutch markets had *not* been based exclusively on the results of the econometric model. In these circumstances, the Commission claimed that it was contradictory for the General Court to annul its Decision on the basis of an infringement of the rights of defense while at the same time concluding that the revised econometric model was capable of overriding the qualitative information taken into account by the Commission (given that it could not have reduced the number of Member States in which the merger would have given rise to a significant impediment to effective competition).[16]

This argument was dismissed by the Court of Justice, which considered that the premise on which the argument was based was incorrect. The Court concluded that the Commission had wrongly assumed that the infringement of the rights of defense would only lead to the annulment of the Decision if, in the absence of the procedural irregularity, the Decision would have been different in content. Indeed, the Court considered that an infringement of the rights of defense should be able to lead to the annulment of a Commission Decision provided that – in the absence of such infringement – there was "*even a slight chance*" that the merging parties would have been better able to defend themselves.[17]

4. Potential impact of the Judgment

The Court of Justice's Ruling in the *UPS Case* has a number of important implications on EU merger practice.

(i) This Ruling constitutes an emphatic application of the doctrine of "equality of arms" as an integral part of the rights of defense, insofar as it emphasizes the notifying parties must have access to the documentation that makes up the case against them. Moreover, the Court of Justice also found fault with such an act of non-disclosure by the Commission because it would risk the effectiveness of review by the Courts. To the extent that the Commission bases its objections to a merger on certain facts, these must be disclosed to the notifying parties to afford them the opportunity of defending themselves during the review period, rather than consigning their objections to an appeal process after their merger has been shelved. In the circumstances of the case, the evidence contained in the final version of the econometric model relied upon by the Commission was clearly material to its substantive review, and therefore should have been made available by the Commission.

Hairs may no doubt be split in the future about which acts of Commission non-disclosure might be actionable, but the Court was clear that there was little doubt that the notifying parties' defense during the merger review was seriously hampered by the Commission's act of non-disclosure.

(ii) The Court elevates the rights of the defense to a higher standard than has been acknowledged in previous case-law, insofar as the Court did not consider it necessary to engage in an enquiry into whether the Commission's act of non-disclosure amounted to an error whose magnitude was likely to change the nature of its final conclusions (*i.e.*, a "manifest error").[18] The Court reference to "*even a slight chance*" appears to constitute an important erosion of the Commission's otherwise wide discretion in interpreting economic evidence, as it will now be aware that its discretion will need to exercised alongside a full disclosure of the underlying supporting evidence. It will only be in unusual circumstances that the Commission will be able to assert with confidence that an act of non-disclosure would not have been capable of affecting its substantive conclusions.

The particular fact pattern in the *UPS Case* has probably played a very material role in the Court of Justice's Ruling, suggesting that no hair-splitting was necessary. For example, the econometric model was revised after exchanges that had been made in the course of the Oral Hearing held in the latter stages of the Commission's review. Moreover, UPS had contended that those changes, rather than being an appropriate response to what had been argued at the Oral Hearing, were changed unilaterally by the Commission in ways which were arguably inappropriate and which were unsubstantiated in the text of the Commission's Decision, being *only* revealed in the course of the proceedings before the General Court. This fact pattern therefore suggests that this was a case which amounted to much more than a situation of a notifying party submitting evidence late in the review process and thereby compromising the Commission's tight review deadlines.

As a result, it was clear that the Court was concerned with the potential misuse or biased use of economic models by the Commission, having stressed that the methodological basis behind the models used "*must be as objective as possible in order not to prejudge the outcome of the analysis on way or another*".[19]

What remains unclear from the Ruling is whether an enquiry into whether a final Decision was affected by a Commission infringement will still be required by the Court in relation to failings of a less fundamental nature, so that the Court's tough stance regarding the infringement of the rights of defense applies only where the nature of the infringement is sufficiently egregious, as it was in relation to the

handling of key economic evidence. What falls short of a failure to provide access to a revised econometric model is therefore likely to require clarification through subsequent case-law.

(iii) In agreeing to UPS's procedural challenge, the European Courts have opened up the possibility that the actions for damages lodged by UPS and others[20] may bear fruit. To date, actions for damages for blocked mergers have resulted in relatively meagre damages awards by the European Courts, other than in the *Schneider/Legrand Case*,[21] where the Commission's procedural infringements were wilful and serious. Given the underlying circumstances in the *UPS Case*, it cannot be discounted that the Court may be willing to adopt the approach to damages taken in *Schneider/Legrand*. Will the Court of Justice's uncompromising stance on the gravity of the procedural failings in the *UPS Case* have a similar effect in ramping up the quantum of damages to which the Commission may be subject? Practitioners will await with interest the approach of the European Courts to the damages claims that will follow in the wake of the *UPS Ruling*.

(iv) It seems inevitable that the Commission will react to the Court's strong rebuke by modifying its procedures of review. One can envisage one of two possibilities, neither of which is ideal from a practitioner's perspective and neither of which addresses the procedural problem really at issue in the *UPS Case*.

First, the Commission might move away from its current flexible procedure of allowing notifying parties the ability to file submissions virtually throughout the course of the review period. Instead, notifying parties might find themselves in a position of being obliged to file certain types of economic data within specified time limits in order for them to be taken into account. In this way, multiple modifications to economic evidence might become procedurally untenable. The major drawback of this approach would be that the notifying parties might not be able to respond sufficiently quickly with appropriate economic evidence, especially if the Commission is exploring a novel theory of harm.

Second, the Commission might open up the possibility of multiple exchanges on economic evidence, but only if the procedural *quid pro quo* is a relatively elastic extension of the period of review. Sacrificing the commercial benefits of a relatively certain fixed period of review for an open-ended review period would not be seen in many quarters of the business community as desirable.

One thing is clear: given the increasing importance attached by the Commission to economic evidence, the procedural aftermath of the *UPS Case* will be felt for some time in the ways in which such economic evidence is processed. Whether or not the approach of the European Courts signals an increased willingness of the Courts to subject the Commission's broad discretion in examining economic evidence remains to be seen.

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[1] See ECJ's Judgment in Case C-265/17 P – *European Commission v United Parcel Service, Inc.*, 16.01.2019, ECLI:EU:C:2019:23. Available at: http://curia.europa.eu/juris/document/document.jsf;jsessionid=6EDA43936703CA52E17A4149562E80E2?text=&docid=209848&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=7507536

[2] See ECJ's Judgment in Case T-194/13 – *United Parcel Service, Inc. v European Commission*, 07.03.2017, ECLI:EU:T:2017:144. Available at: http://curia.europa.eu/juris/document/document.jsf?text=&docid=188600&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=7508760

[3] See the European Commission's Decision on Case COMP/M.6570 — UPS/TNT Express, 30.01.2013. Available at: http://ec.europa.eu/competition/mergers/cases/decisions/m6570_20130130_20610_4241141_EN.pdf

[4] An SO is a document which summarizes the Commission's *prima facie* antitrust concerns regarding the merger. While the arguments in the SO serve as the basis for the Commission's final conclusions in support of its Decision to block the merger, the Commission is not bound to follow its views in the SO as a matter of law. See para. 36 of the ECJ's Ruling and para. 63 of ECJ's Judgment in Case C-413/06 P - *Bertelsmann and Sony Corporation of America v Impala*, 10.07.2008, EU:C:2008:392. Available at: http://curia.europa.eu/juris/document/document.jsf?text=&docid=67584&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=9868410

[5] See para. 24 of the ECJ's Ruling.

[6] See para. 26 of the ECJ's Ruling.

[7] See para. 50 of the ECJ's Ruling.

[8] See para. 29 of the ECJ's Ruling.

[9] See paras. 36 and 37 of the ECJ's Ruling.

[10] See para. 50 of the ECJ's Ruling.

[11] See para. 56 of the ECJ's Ruling.

[12] See paras. 59 to 62 of the ECJ's Ruling.

[13] See paras. 64 to 68 of the ECJ's Ruling.

[14] See para. 66 of the ECJ's Ruling.

[15] See paras. 65 to 67 of the ECJ's Ruling.

[16] See para. 62 of the ECJ's Ruling.

[17] See paras. 68 and 69 of the ECJ's Ruling.

[18] See para. 68 of the ECJ's Ruling.

[19] See para. 53 of the ECJ's Ruling.

[20] According to the official notice published in the EU's official journal, UPS brought an action against the European Commission on 29.12.2017. The Irish airline ASL also brought an action against the European Commission on 11.09.2018. Both notices are available at: http://res.cloudinary.com/gcr-usa/image/upload/v1519658653/EU_Journal_ks934v.pdf. and https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62018TN0540&from=EN

[21] See ECJ's Judgment in Case C-440/07 P - *Commission v. Schneider Electric SA*, 16.07.2009, ECLI:EU:C:2009:459. Available at: http://curia.europa.eu/juris/document/document.jsf?docid=72486&doclang=en

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