TELECOMS MERGERS UNDER THE EU MERGER REGULATION: A NEW FRAME OF REFERENCE?

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I. INTRODUCTION

On September 1, 2016, the EU Commission ("Commission") conditionally cleared a proposed joint venture that will combine the Italian mobile network operating businesses of VimpelCom and CK Hutchison Holdings (respectively, WIND Telecomunicazioni S.p.A ("WIND") and H3G S.p.A. ("3 Italia")).[2] The Commission's clearance is conditional on the divestment of sufficient assets that will allow Iliad SA to enter the Italian market as a new mobile network operator ("MNO"). This is the only "four-to-three" mobile network consolidation cleared by the Commission since the present Competition Commissioner, Margrethe Vestager, took office in October 2014 and comes in the wake of the prohibition of Hutchison's proposed acquisition of O2 in the UK in May 2016 and the abandonment in September 2015 of the Danish merger between TeliaSonera and Telenor after the parties to that deal failed to agree on commitments to address the Commission's concerns.

Over recent years the Commission has developed a rich decisional practice in response to a wave of consolidation in the telecoms sector. This gives rise to a number of interesting points on competition law and economics. In particular, a claim frequently made at the industry level is that, in the absence of in-market M&A consolidation, one or both of the parties to a merger would not be able to finance the investments necessary to remain competitive in an industry characterized by rapid technological changes and therefore would

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[2] Case M.7758, *Hutchison 3G Italy/WIND/JV*, Commission Decision of September 1, 2016. The authors advised WIND and its controlling shareholder, VimpelCom Ltd, on the European merger control aspects of this transaction.

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not be able to continue to deliver the benefits of innovation to end customers. Evaluating the strength of this claim in competition law and policy terms involves establishing: (i) the most likely conditions of competition in the absence of the merger (the "counterfactual"); (ii) what, if any, efficiencies are generated by the merger (and in particular confirming that those efficiencies are "merger specific"); (iii) the likely overall effect of the merger on consumer welfare; and (iv) what remedies may be required to address any negative effects on competition.

This paper considers some of the key trends in relation to those themes based on the Commission's decisional practice in reviewing MNO consolidations under EU Merger Regulation ("EUMR") in light of the recent clearance in *Hutchison 3G Italy/WIND*.[3]

II. THE COUNTERFACTUAL IN MNO CONSOLIDATIONS

For mobile telecoms mergers, as for any merger, a critical consideration is whether the competitive constraint posed by the merging parties can reasonably be predicted to be greater absent the merger as separate competitors (i.e. in the counterfactual scenario) than compared to the constraint that would be exerted in the market by the combined entity (i.e. the "factual scenario").

The Commission's position on this question is set out paragraph 9 of its Horizontal Merger Guidelines:

> In assessing the competitive effects of a merger, the Commission compares the competitive conditions that would result from the notified merger with the conditions that would have prevailed without the merger. In most cases the competitive conditions existing at the time of the merger constitute the relevant comparison for evaluating the effects of a merger. However, in some circumstances, the Commission may take into account future changes to the market that can reasonably be predicted. It may, in particular, take account of the likely entry or exit of firms if the merger did not take place when considering what constitutes the relevant comparison.

The Commission has assessed claims in each of the last five mobile telecoms consolidations considered under the EUMR that the competitive constraint exercised by one or both of the merging parties would deteriorate *vis-à-vis* the pre-merger *status quo*. In *Telefónica Deutschland/E-Plus*,[4] for example, the merging parties argued that E-Plus' "competitive potential would be limited in the absence of the proposed transaction due to the growing importance of data"[5] and that "E-Plus' investment capabilities are limited and it is questionable whether it would be able to build a competitive network in a stand-alone scenario in due time."[6] In a similar vein, the merging parties in *Hutchison 3G UK/Telefonica Ireland*[7] argued that while Three Ireland may have had every incentive to continue to grow

[3] Council Regulation (EC) No 139/2004 of January 20, 2004 on the control of concentrations between undertakings, 2004 O.J. L 24/1.
[4] Case M.7018, *Telefónica Deutschland/E-Plus*, Commission Decision of July 2, 2014. Allen & Overy LLP advised KPN and E-Plus in relation to this matter.
[5] Case M.7018, at para. 335.
[6] Case M.7018, at para. 338.
[7] Case M.6992, *Hutchison 3G UK/Telefonica Ireland*, Commission Decision of May 28, 2014.

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and compete, it was not likely to have the ability to do so. In particular, the fact that Three Ireland had been loss making in each of the eight years since its market entry meant that it had been unable to make the necessary investments required to grow its market share while "its network will be congested more quickly than its rivals' due to its smaller spectrum holdings."[8] More recently, the Commission assessed arguments in *Hutchison 3G UK/Telefonica UK*[9] that Three UK was sub-scale and unable to grow organically absent the notified transaction.[10] In *Hutchison 3G Italy/WIND* the merging parties argued that, absent the transaction, neither would be able to finance the 4G network investments required to close a widening competitive gap between them and the two largest MNOs operating in the market, Telecom Italia Mobile ("TIM") and Vodafone.

In each of these cases, however, the Commission ultimately rejected merging parties' claims that an appropriate counterfactual analysis should take into account a deterioration of the competitive constraint posed by one or both of the merging MNOs. While each assessment is based on the particular facts of the case at hand (and, in practice, those facts are often redacted from the public version of the Commission's decisions), a number of common themes can be seen in the Commission's approach to assessing the counterfactual in mobile telecoms mergers.

First, the Commission places considerable weight on internal documents evidencing planned network investments and customer surveys of network quality. In *Telefónica Deutschland/E-Plus*, for example, the Commission noted that "In the absence of the proposed transaction, E-Plus plans to roll out […] network elements for its 4G network by the end of […] and to achieve [80-90]% outdoor population coverage with its 4G network by then."[11] Likewise, in *Hutchison 3G UK/Telefonica Ireland*, the Commission noted that "Three's 2013 Budget Plan shows Three's continued commitment to customer growth on a stand-alone basis."[12] With respect to claims that the stand-alone networks of merging parties will lose ground to those of larger rivals absent the notified transaction, again the Commission has repeatedly emphasized apparently contradictory evidence from internal documents.

Second, the Commission appears to be highly skeptical of merging parties' arguments that they would be incapable of profitably financing necessary investments. The Commission's decisional practice in this respect has put increasing weight on an assessment of merging parties' historic financial performance relative to competitors taking into consideration a variety of metrics including EBITDA,[13] capital expenditure ("CAPEX"), cash flow, weighted average cost of capital ("WACC") and return on capital employed ("ROCE").[14]

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[8] Case M.6992, at para. 475.

[9] Case M.7612, *Hutchison 3G UK/Telefonica UK*, Commission Decision of May 11, 2016.

[10] Case M.7612, at para. 682.

[11] Case M.7018, at para. 402.

[12] Case M.6992, at para. 484.

[13] Earnings before interest, tax, depreciation and amortization. In *Hutchison 3G UK/Telefonica UK*, the Commission noted that EBITDA was a useful indicator of financial performance to the extent that it "measures the profitability of core operations as it excludes factors…that are less relevant to the profitability of day-to-day operations and are discretionary to a business, such as the type of financing…by excluding interest expenses, EBITDA excludes the effect of bad, debt-financed investment decisions in the past, which is unrelated to the current operational performance of the business" (at para. 709).

[14] The Commission noted in *Hutchison 3G UK/Telefonica UK* that A ROCE equal to or greater than the WACC is an indication that a business generates sufficient returns to its investors.

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Critically for the counterfactual analysis, however, the Commission also places considerable emphasis on merging parties' expected future financial performance as evidenced by business plans, investment forecasts and other internal documents. Most recently, in *Hutchison 3G Italy/WIND*, following a detailed review of the notifying parties' internal documents, the Commission concluded that "WIND's shareholders would have the incentives to financially support WIND if this was needed in order to maintain its competitiveness in the market"[15] and that as a result WIND was likely to have the ability and incentive to continue exerting an important competitive constraint.

More generally, the Commission appears to be of the view that for the purposes of identifying the appropriate counterfactual in mobile telecoms mergers, competing aggressively on price is often a viable competitive strategy for operators that may otherwise struggle to match the levels of network investment (and therefore quality of service) deployed by larger rivals. In *Telefónica Deutschland/E-Plus*, for example, the Commission noted that "a number of respondents consider that E-Plus would continue to differentiate itself based on aggressive pricing, which would compensate for possibly lower network quality."[16] Likewise, the Commission placed considerable weight on evidence from internal documents collected from the merging parties in *Hutchison 3G Italy/WIND* that showed price remained one of the most important factors in determining customers' choice of network.

Finally, in a number of cases the Commission has been willing to speculate that a network sharing agreement ("NSA") could constitute an appropriate counterfactual to a merger between MNOs, in particular where parties have argued that they would otherwise face difficulties in independently financing necessary network investments. This is a crucial point. The fact that NSAs are theoretically possible is not in dispute. However, there is a wide range of possible NSAs (each with varying degrees of network integration) and the ability of parties to enter into an NSA is affected by a number of case-specific factors. If the Commission wants to rely on an NSA as a counterfactual to an assessment of a merger under the EUMR, then it is clear from the Horizontal Guidelines that it must first prove such an outcome is likely in the circumstances of the individual case and that it can reasonably be predicted. Conversely, any previous attempts by merging parties to reach an NSA which ended in failure (for instance in light of investment and/or benefit asymmetries between those parties under an NSA) would constitute *prima facie* evidence that an NSA is in fact not a counterfactual that can reasonably be predicted in the circumstances. It would then be for the Commission to disprove that presumption conclusively based on the available evidence.

Yet in *Hutchison 3G Italy/WIND* the Commission considered as part of its counterfactual analysis that the merging parties would be able to address difficulties in matching the investments of larger rivals by entering into an NSA as an alternative to the joint venture, concluding that:

> [s]hould H3G aim to accelerate its 4G network coverage and reduce its network capital expenditures, based on the available evidence, it would be able to rely on alternatives to the Transaction. H3G may for instance consider entering into NSAs with WIND...NSAs appear to be an option capable of delivering significant

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[15] Case M.7758, at para. 769.

[16] Case M.7018, at para. 406.

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financial benefits to both WIND and H3G.[17]

If merging parties discharge their burden of proof in showing that absent a notified transaction the competitive position of one or both of the merging parties will deteriorate (e.g. through an inability to able to finance necessary investments), as a matter of principle, the Commission cannot simply assert that because NSAs exist between certain parties in certain markets, such a theoretically possible alternative transaction is an appropriate counterfactual. To do so would effectively amount to the Commission substituting its own judgement for the commercial experience and evaluation of the parties. Indeed, the Commission's own assessment in *Hutchison 3G UK/Telefonica UK* of the harm that the merging parties in that case could do to already existing NSAs (discussed below) suggests that NSAs are by their nature difficult to maintain where parties' incentives are not closely aligned – let alone agree in the first place. This of course interacts with the Commission's approach to efficiencies and ultimately its assessment of a merger's overall impact on consumer welfare.

III. THE COMMISSION'S APPROACH TO EFFICIENCIES

Under the Horizontal Merger Guidelines, for the Commission to take account of efficiency claims in its assessment of a merger and be in a position to conclude that as a consequence of those efficiencies there are "no grounds for declaring the merger to be incompatible with the common market," the efficiencies must satisfy the cumulative conditions of benefitting consumers, being merger-specific and being verifiable.[18]

To date, the Commission has found that most of the efficiencies claimed by notifying parties in MNO mergers fail to satisfy this test. Often, although not exclusively, on the basis that they have not been shown to be merger-specific.

The ability to enter into an NSA is crucial to the merger specificity analysis in mobile mergers and raises real questions as to whether the test is applied correctly as a matter of policy. The first such detailed assessment was conducted by the Commission in its review of *H3G Austria/Orange Austria*.[19] In that case, notwithstanding evidence that a NSA would not be workable given the very different commercial strategies pursued by each party, the Commission felt that it could not "rule out alternatives just because they might be more cumbersome or expensive for H3G to implement…[NSAs] are plausible means of reducing capacity constraints. These are established business practices in the industry concerned. Thus more evidence would be needed to show why these measures would not be realistically chosen in the absence of the merger."[20]

The Commission reached a similar conclusion in *Hutchison 3G Italy/WIND* where it found that "it is undisputable that network sharing agreements constitute common business practice in the telecommunications industry and have been implemented successfully in a

[17] Case M.7758, at paras, 619 and 621.
[18] Horizontal Merger Guidelines, at para. 78.
[19] Case M.6497, *Hutchison 3G Austria/Orange Austria*, Commission Decision of December 12, 2012. The authors advised Orange Austria and its controlling shareholder, Mid Europa Partners LLP, on the European merger control aspects of this transaction.
[20] Case M.6497, at para. 417.

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number of Member States"[21] and, in particular given significant differences between each of the notifying parties' spectrum portfolios, that "spectrum compensation from H3G to WIND would not represent an impediment" to an NSA.[22] In the Italian case, the Commission also conducted a detailed assessment of the cost savings that could be expected to arise under a variety of different types of NSAs, ultimately concluding that entering into an LTE NSA would result in substantial cost reductions and revenue synergies, while preserving a degree of retail competition that would be otherwise lost with the merger. On this basis, the Commission found that the merging parties had failed to demonstrate within the framework of the Horizontal Merger Guidelines that the network efficiencies arising from the notified transaction were sufficiently merger specific, likely to materialize and able to counter the anti-competitive effects that the Commission considered would otherwise result.

In contrast to the Austrian and Italian mergers, however, at the time of *Hutchison 3G UK/Telefonica UK* each of the four UK MNOs was a party to one of two NSAs active in the UK market: "MBNL" (between Three and EE) and "Beacon" (between O2 and Vodafone). The efficiencies claimed by the merging parties in the context of the Commission's review of the notified transaction were therefore limited to those not already achievable under the terms of their existing NSAs. However, neither MBNL nor Beacon involved the sharing of spectrum between NSA partners. The merging parties in the UK case therefore argued that the proposed transaction would generate efficiencies primarily through radio area network ("RAN") consolidation, including by way of more efficient use of spectrum, thereby resulting in increased network capacity, quality and speed. The Commission's assessment in that case, however, found that a spectrum sharing arrangement would allow the Parties to achieve "virtually the same network benefits as the network efficiencies which, according to the Notifying Party, would arise from the Transaction."[23] The Commission went on to recognize that while a hypothetical spectrum sharing agreement between the merging parties would still give rise to competition concerns vis-à-vis the non-merging MNOs party to the existing UK NSAs (discussed further below), and may also adversely affect overall investment incentives in the industry, such an arrangement:

> [w]ould not give rise to an elimination of price competition at the retail or wholesale market where the Parties would remain in competition…It is therefore a less anti-competitive means to achieve the network efficiencies claimed by the Notifying Party, even if the approval of any such spectrum sharing agreement by the competent authorities might require remedies to avoid harm to the Parties existing network sharing partners.[24]

This raises the question of how the Commission should assess a potential consumer-welfare efficiency which may at the same time give rise to a potential reduction of competition.[25]

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[21] Case M.7758, at para. 1512.

[22] Case M.7758, at para. 1568.

[23] Case M.7612, at para. 2473.

[24] Case M. 7612, at para. 2483.

[25] Indeed, the Commission recently opened a formal investigation under Article 101 of the Treaty on the Functioning of the EU into an existing NSA arrangement in the Czech Republic between O2 and T-Mobile, citing concerns as to whether the NSA would slow down quality improvements in existing infrastructure and/or delay the deployment of LTE and future technologies. In announcing the investigation on 25 October 2016, Commissioner Vestager commented that "Network sharing agreements can bring about efficiencies, such as reduced deployment costs and may allow for network expansion to previously unserved areas. But, in some circumstances, network sharing may also

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Ultimately this can only be done in an exercise of balancing the negative effects with pro-competitive effects but if the latter is limited to efficiencies achievable without an NSA that exercise in unduly distorted.

Interestingly, in establishing that spectrum sharing would have been a realistic alternative to the notified transaction in the UK, the Commission cited the example of the spectrum sharing agreement between TeliaSonera and Telenor in Denmark as evidence that such agreements are "feasible and an established business practice in the mobile telecommunications industry."[26] This position was echoed by Commissioner Vestager in a speech delivered in October 2015:

> In practice, we assess whether post-merger investment plans are credible and likely, merger-specific, and with benefits for end-consumers as opposed to shareholders. However, only a fraction of the efficiency submissions we have seen in successive cases have met these criteria. In this context, we should not forget that mobile network operators can share mobile networks and thus benefit from large efficient networks without the need for consolidation. The Danish case is a good example of this.[27]

On this basis, it would appear that notifying parties will continue to face an extremely high evidential threshold in showing that in-market MNO consolidations generate efficiencies that meet the criteria set out in the Commission's Horizontal Merger Guidelines.

IV. ASSESSING COMPETITIVE EFFECTS

Not all 4-3 mobile mergers are equal. Clearly there are some common themes but the Commission does carry out a very case-specific assessment and recent cases (in particular the UK and the Italian cases) have highlighted some interesting aspects of the analysis of competition effects. We have selectively chosen two for the purposes of this article: network competition and coordinated effects.

A. Network Competition

In contrast to the Austrian and Italian mergers, at the time of *Hutchison 3G UK/Telefonica UK* each of the four UK MNOs was a party to one of two NSAs already active in the UK market. The Commission's assessment of that transaction therefore included a detailed review of novel theories of harm related to the proposed transaction's impact on the ongoing operation of MBNL and Beacon and the subsequent competitive position of the merging parties' NSA partners. The Commission's assessment was predicated on an observation that "network sharing arrangements require a certain degree of alignment of interests between the network

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reduce competition on the market. The network sharing agreement between the two major operators in the Czech Republic covers most of the country. We need to ensure that it will not reduce infrastructure competition and innovation" (European Commission, Antitrust: Commission opens formal investigation into mobile telephone network sharing in Czech Republic, Press Release IP/16/3539, 25 October 2016 (available at http://europa.eu/rapid/press-release_IP-16-3539_en.htm)).

[26] Case M. 7612, at para. 2482.

[27] *Competition in telecom markets*, Speech given by Margrethe Vestager to the 42nd Annual Conference on International Antitrust Law and Policy Fordham University, October 2, 2015 (available at https://ec.europa.eu/commission/2014-2019/vestager/announcements/competition-telecom-markets_en).

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sharing partners to function properly."[28] In particular, the Commission considered that because the UK NSAs pre-merger "combine partners with certain shared characteristics in term of available spectrum,"[29] there was a risk that the proposed transaction would disrupt the alignment of those interests to the detriment of the competitive position of either EE or Vodafone (or both) insofar as the merged entity would not be incentivized to continue participation in both NSAs in the long term.

The Commission also identified a concern that the merged entity would be able to de-prioritize one of the shared networks without harming its own services to the same extent as those of the relevant NSA partner. While acknowledging that each of Beacon and MBNL included contractual protections where one partner fails to fulfil its obligations, the Commission concluded that:

> [t]he proper functioning of a network sharing arrangements [sic] requires more than the simple application of contractual terms. It also needs practical solutions to questions and situations that have not been foreseen in the contracts. Therefore, contractual protections by themselves are insufficient to ensure a proper functioning of a network sharing arrangement.[30]

On this basis, the Commission found that the proposed transaction could be expected to give rise to a significant impediment to effective competition ("SIEC") insofar as it would harm the competitive position of either one or both of the merging parties' NSA partners.

However, the Commission's finding that the UK NSAs would be disrupted through a dis-alignment of the NSA partners' interests seems to be at odds with its position in the Italian case – in the context of assessing hypothetical NSAs as an appropriate counterfactual – that: "numerous network sharing agreements that have been concluded in Europe and in the World show that the incomplete nature of contracts is not an obstacle to the closing of these cooperation agreements and that mitigating factors can be devised to avoid disagreements or opportunistic behaviour."[31]

The dynamic of network competition should make a difference in the Commission's substantive assessment of any merger-specific efficiencies claimed by notifying parties, as well as in the balancing act required to assess a merger's overall impact on consumer welfare. That dynamic can also clearly make the difference in relation to merging parties' ability to offer effective and commercially acceptable remedies to allay competition concerns. Both points are discussed further below.

B. Retail Level a New Focus on Coordinated Effects

In *Hutchison 3G Italy/WIND*, the Commission concluded the transaction was likely to give rise to non-coordinated anti-competitive effects on the retail market for mobile telecoms in Italy. It found that as the merged entity would have significant market share, it would "not have the incentive to compete on the market in the same way as the Parties did before the Transaction separately."[32] The Commission's reasoning in this respect seems to be based mostly on unsubstantiated (and sometimes self-serving) responses to the Commission's market

[28] Case M.7612, at para. 1230.
[29] Case M.7612, at para. 1238.
[30] Case M.7612, at para. 1241.
[31] Case M.7758, at para. 1608.
[32] Case M.7758, at para. 952.

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investigation questionnaires and a selection of some historic public statements by competitors or analysts. However the Commission also carried out a very deep and detailed analysis of price effects expected to arise from the notified transaction (to which an entire Annex of the Commission's decision is dedicated). The key question for the Commission to assess therefore ultimately relates to the interaction between the price effects identified in that analysis and the efficiency claims of the merging parties, leading to a comprehensive assessment of the merger's overall impact on consumer welfare (discussed further below).

One of the interesting aspects of *Hutchison 3G Italy/WIND* relates to the weight attributed to the coordinated effects theory of harm. In its decision to open in-depth proceedings in *H3G Austria/Orange Austria*, the Commission felt that it could not rule out potential harm to competition arising through coordinated effects. In its final decision, however, while noting that some characteristics of the market may have been conducive to coordination and some past behavior of MNOs could point in that direction, the Commission concluded that the evidence available on potential coordinated effects did not meet the requisite standard of proof to establish an SIEC. Likewise, the Commission's decision in *Hutchison 3G UK/Telefonica Ireland* found that Irish mobile telecoms markets exhibited a number of characteristics conducive to coordination. In particular the Commission was concerned that a high degree of price transparency at the retail level would allow MNOs to both reach terms of coordination and detect any deviation therefrom. The Commission also rejected the merging parties' claim that mobile virtual network operators ("MVNOs") could be expected to disrupt any potential coordination – in part because the largest MVNO in Ireland, Tesco Mobile, was jointly controlled by one of the merging parties. The Commission recognized, however, that a number of factors suggested coordination would *not* be likely. In particular, the Commission noted that with a market share of 20 percent by subscribers and 18 percent by revenues, Eircom would be a much smaller MNO than the two market leaders post-merger and would therefore have an incentive not to follow a coordinated strategy. The Commission ultimately concluded that it did not need to reach a definitive position because the commitments offered by the notifying party to remedy potential unilateral effects in the Irish markets would also exclude the possibility of the transaction giving rise to coordinated effects. Similarly, in its decision to open an in-depth investigation in *Telefónica Deutschland/E-Plus*, the Commission felt that it could not rule out potential coordinated effects, in part because of a high degree of price transparency but also because that transaction would have created an increase in symmetry in respect of the market shares and quality positioning of the three remaining MNOs. Again, however, the Commission did not reach a definitive position on the likelihood of coordinated effects arising in that case as it found that the commitments offered would ensure MVNOs were in a position to disrupt any possible coordination between the remaining MNOs.

The Commission's press release announcing an in-depth investigation of *Hutchison 3G UK/Telefonica UK* also identified concerns that a reduction in the number of competing MNOs following the merger would increase the likelihood of coordination. Strikingly, however, coordinated effects are not mentioned at any point in the 685 pages of the Commission's final decision in that transaction.

In contrast, potential coordinated effects were a key element of the Commission's theory of harm in *Hutchison 3G Italy/WIND*, where the Commission found that the notified transaction would have increased both the incentives and ability for MNOs to reach terms of coordination. The Commission also identified a number of factors to suggest that

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coordination would be sustainable. In relation to the former, the Commission noted that not only would the merger reduce the number of MNOs from four to three, it would also remove a "maverick" competitor from the market insofar as H3G's relatively small market share meant that it would otherwise have had a much lower incentive to engage in coordination and would instead be incentivized to win customers through aggressive price cuts.[33] As with its assessment in *Telefónica Deutschland/E-Plus*, the Commission also found that the notified transaction would result in a relatively symmetric market of three MNOs with similar scale and market shares. In relation to the ability to reach coordination, the Commission found that MNOs in Italy had previously attempted to engage "in behaviour that could be considered the result of coordination,"[34] including with respect to waves of parallel price increases during Q4 2013 and Q1 2014. The Commission's assessment of this past conduct referred to a number of the parties' internal documents, as well as public statements made by WIND, Vodafone and TIM, in support of its conclusion that H3G's aggressive pricing was the primary reason coordination could not be sustained absent the notified transaction and that "the MNOs also shared the same view as to what would be the remedy to get rid of the two factors – H3G's aggressive tariffs and the MNOs' [below-the-line] tariffs – that prevented a full-fledged price stabilisation. That is to say, a merger between H3G and WIND."[35] The Commission also found that MNOs would be able to quickly detect and punish (including through price wars) any deviation from the terms of coordination which, in itself, would constitute a sufficiently credible threat to deter MNOs from deviating in the first place.

Finally, the Commission identified a number of practices that – while not strictly necessary for coordination to arise – would make it easier to reach and sustain coordination post-merger. In particular, the Commission noted that MNOs engaged in regular conference calls with their shareholders and investors (which were closely followed by the managers of competing MNOs) that could be used to make public statements to: (i) communicate the terms of coordination; (ii) threaten to adopt retaliatory measures in case of deviation; (iii) suggest actions to take coordination to a new stage; and (iv) thereby make it easier to reach and sustain coordination. In this respect, the Commission also identified investment banks as contributing to the likelihood of coordination in the Italian markets by conveying information to MNOs regarding each other's results and intended market strategies: "In a regime of coordination post-Transaction, the role of investment banks would therefore facilitate reaching terms of coordination and making it sustainable in time."[36]

V. BALANCING PRO- AND ANTI-COMPETITIVE EFFECTS: CONSUMER WELFARE

It is an established principle of European case law that the Commission must determine whether a transaction notified under the EUMR is, overall, likely to give rise to an SIEC with no

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[33] The Commission's decision noted at paragraph 975 that firms with a comparatively low market share benefit appreciably less from coordination attempts than larger incumbents, since they have a smaller customer base on which they could earn a supra-competitive margin. Such firms are therefore much less inclined to cement the existing market structure by agreeing to engage in accommodative pricing and, on the contrary, they have a comparatively stronger incentive to try and win over customers from rivals through price cuts.

[34] Case M.7758, at para. 1049.

[35] Case M.7758, at para. 1076.

[36] Case M.7758, at para. 1201.

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presumption as to either compatibility or incompatibility.[37] In doing so the Commission's assessment must bring together both its analysis of anti-competitive effects as well as its analysis of any efficiencies claimed by notifying parties. That is because in mergers that create not only supply-side efficiencies (e.g. cost reductions) but also demand-side efficiencies (e.g. quality improvements)[38] price effects are not a sufficient metric to determine the net impact on consumer welfare arising from that transaction. The Commission's decision in *Hutchison 3G Italy/WIND* indicates that this is an area where the Commission should adjust its policy to ensure that this balancing is not relegated to the category of an impossible and ultimately pointless exercise.

A standard methodology to quantify the consumer effects of a merger consists in producing a "merger simulation" model that weighs price effects and efficiencies (both supply- and demand-side) to estimate whether a given merger will be overall welfare enhancing. Crucially, a balanced analysis of a merger cannot be limited to a mono-dimensional assessment of price effects alone. In *Hutchison 3G Italy/WIND*, the parties submitted such a model and the Commission considered that some elements of it (in particular the online survey on which it was based) had a number of shortcomings which cast doubt on the verifiability of the conclusions. However the key policy point here relates to the burden of proof and standard required applicable to this type of detailed analysis relative to that of a collection of statements in internal documents and analyst presentations which are relied upon selectively (often ignoring evidence of a similar nature in support of claimed efficiencies).

The threshold of merger-specificity also plays a key role here. If the balancing act which it is ultimately incumbent on the Commission to carry out based on the evidence produced by the parties is constrained by an unreasonably strict and expansive test of what is merger specific (such that the Commission is effectively free to speculate on the viability of alternative transactions, even in the presence of evidence that those transactions had previously been attempted but failed), then this balancing act is in practice negated with a corresponding negative impact on merger control policy. Moreover if efficiency claims are negated as a result of a putative alternative arrangement which itself would also necessarily give rise to negative (albeit potentially less pronounced) competition effects (an NSA in the case mobile telecoms mergers) the balancing act cannot artificially assume that the proposed merger does not deliver the benefits that would also be produced by the alternative (less competitively harmful) arrangement.

VI. REMEDIES

Perhaps more than any other aspect of the decision making process, a clear trend can be seen in the Commission's approach to assessing remedies in MNO mergers. In particular, while each case – and therefore the appropriateness of remedies offered by the notifying parties – is assessed on its merits, the Commission has been gradually moving away from remedies designed to boost the competitive constraint posed by MVNOs at the retail level of the market, albeit with a structural element of spectrum divestment (Austria, Ireland and

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[37] See, for example, Case C-413/06P, *Bertelsmann and Sony Corporation of America v. Impala*, [2008] E.C.R. I-4951, at para. 48.

[38] D. Evans and J Padilla, "Demand-side Efficiencies in Merger Control" (2003) 26 World Competition, 167.

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Germany) towards remedies designed to secure the entry of a fully-fledged new network operator (UK, Italy).

In the Austrian case, for example, the notifying party committed to make available wholesale access to 30 percent of its network for up to 16 MVNOs on the basis of unit prices set out in a published "reference offer." It also committed not to complete the transaction before it had entered into an up-front agreement with one MVNO approved by the Commission on the terms of that reference offer. However, there was no obligation on the remedy-taker to commit to any minimum amount of capacity or usage. In addition, the notifying party committed to offer for divestment 2 x 10MHz of spectrum in the 2600MHz frequency band to a new entrant (which was to be divested alongside spectrum in the 800MHz frequency band, reserved from an upcoming spectrum auction by the Austrian telecoms regulator). Contingent on that spectrum being acquired, the notifying party also offered to divest unwanted sites following consolidation of the merged networks and to enter into a national roaming agreement.

However, following criticism of that remedies package (including from the Austrian telecoms regulator) for failing to secure any significant new entry to the market, the remedies offered in each of the Irish and German cases were designed to incentivize the in-coming remedy taker to compete aggressively by committing to an up-front acquisition of a fixed amount of capacity. In both of those cases this included a commitment to sell up to 30 percent of the relevant merged entity's network capacity to MVNOs at fixed payments under terms that would see the MVNO purchaser acquiring a dedicated "pipe" from the merged entity's network for voice and data traffic. In *Telefónica Deutschland/E-Plus*, this involved an up-front sale of network capacity (corresponding to a market share of up to 11 percent) to between one and three MVNOs at fixed payments. In its assessment of that commitment, the Commission noted that "with a fixed capacity that they committed to pay up-front at their disposal, the MVNOs will have increased incentives to fill the capacity they have committed to purchase by offering attractive prices and innovative services."[39] On 29 August 2014, the Commission subsequently approved an agreement between Telefónica Deutschland and Drillisch (which was previously active on the German market as a service provider) pursuant to which Drillisch would acquire 20 percent of the combined entity's capacity with an option to purchase a further 10 percent. Similarly, in *Three/Telefónica Ireland*, the commitment involved a sale of the merged entity's network capacity to two MVNOs at fixed payments. Significantly, Three was required to conclude an access agreement under the terms of the commitments with at least one MVNO prior to completing its acquisition of Telefónica Ireland, subject to the Commission approving the potential purchaser. The Commission noted that "*The main effect of introducing the fixed price/fixed capacity model is that it will create a strong incentive for the MVNO entrant to fill its purchased network capacity by aggressively acquiring customers*."[40] Three subsequently concluded the two MVNO agreements with Liberty Global's UPC and Carphone Warehouse.

To facilitate one (but not both) of the MVNOs which acquired divested capacity transitioning to a full MNO in Ireland at a later date, Three also committed to make available for divestment for a period of ten years from 1 January 2016 one block of 900 MHz

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[39] European Commission, *Mergers: Commission clears acquisition of E-Plus by Telefónica Deutschland, subject to conditions*, Press Release IP/14/771, July 2, 2014 (available at http://europa.eu/rapid/press-release_IP-14-771_en.htm).
[40] Case M.6992, at para. 983.

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spectrum, two blocks of 1800 MHz spectrum and two blocks of 2100 MHz spectrum. Likewise, Telefónica Deutschland also committed to offer to divest spectrum (2x10 MHz in the 2100 MHz band and 2x10 MHz spectrum in the 2600 MHz band) and certain assets (including sites and retail outlets, as well as offering to enter into national roaming and passive network-sharing agreements) to either a new MNO entrant in the context of the upcoming German frequency auctions or to an MVNO who acquired network capacity under the first part of its commitment offer. Finally, Three also committed to continue the "Mosaic" network-sharing agreement with Eircom in Ireland on improved terms, while Telefónica Deutschland committed to extend existing wholesale access agreements and to offer 4G services to the wholesale market, as well as removing certain contractual clauses in its agreements with wholesale customers which could prevent switching to another MNO.

By the time of *Hutchison 3G UK/Telefonica UK* the Commission had begun to move away from the use of MVNOs as a central component of a remedy structure. In that case, the notifying party offered a package of commitments designed to address the Commission's three main theories of harm, namely: loss of competition between the merging parties, harm to the competitive position of the merging parties' NSA partners and harm to the competitive position of MVNOs. A full review of that remedies package is beyond the scope of this paper. However it is notable that while the remedies offered in that case were designed to replicate as far as possible the competitive position of a new entrant MNO, they did not include a commitment to divest individual mobile telecoms assets (such as sites and spectrum rights) to a new entrant MNO. Instead, Hutchison offered to grant a "perpetual fractional network interest" to a new entrant operator ("NEO") in the network operated and/or used by O2 (subject to any limitations contained in roaming or site sharing agreements with third parties, the Network) amounting to a confidential proportion of the Network's total capacity. The commitment included a confidential mechanism to determine the minimum amount of capacity that would be taken by the NEO over time and envisaged that the NEO would pay a fixed price in consideration for the network interest. The notifying party also submitted a term sheet signed with a confidential third party designed to give commercial effect to the NEO commitment. The economic rationale of this proposal is that the level of commitment of the NEO would mimic that of a fully-fledged MNO and therefore produce similar incentives to compete.

However, the Commission noted that the term sheet was not a final agreement and was not submitted as a formal part of the commitments. On that basis, the Commission concluded that the submission of the term sheet did not ensure that there would be timely and likely entry of a new competitor. On substance, the Commission felt that the proposed NEO arrangement should be characterized as a long term access commitment containing optional elements and uncertainties that entailed a long term commercial and technical dependence on the host MNO.[41] Crucially, notwithstanding a right for the NEO to opt out of certain network investments,[42] the Commission's assessment found that a NEO's dependency on the investment decisions of the merged entity might influence its decision as to the Capacity Share it would elect to utilize over time. In rejecting the commitments, the Commission therefore concluded that:

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[41] Case M.7612, at para. 2999.

[42] The Commission noted that the opt-out would not apply to features or services which would lead to an improvement in coverage, capacity, speed or cost of the network.

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> This dependency constitutes a fundamental difference between a NEO and an MNO in the long run as a NEO would not only be required to reimburse the Notifying Party for the costs for the capacity that it intends to utilise, but also for an undefined return on investment, while an MNO can always invest into capacity and get access to it at cost. As a result, a NEO is unlikely to be able to compete effectively against other market participants, and in particular against MNOs.[43]

In contrast to the position of the parties to the UK transaction (each of whom was also party to a NSA with one of the two remaining UK MNOs), the notifying parties in the Italian case were free to offer to divest individual components of their respective mobile telecoms networks to a potential remedy-taker. In that case, the remedies offered consisted of a package of assets and related agreements designed to ensure the entry of a new, independent, MNO to the Italian market and included: (i) 2 x 35 MHz of mobile radio spectrum at various frequency bands (900 MHz, 1800 MHz, 2100 MHz and 2600 MHz); (ii) a divestment and colocation of several thousand mobile base station sites; and (iii) transitional agreements allowing the remedy-taker to make use of the merged entity's network (including in relation to 2G, 3G and 4G technologies) while it builds out its own network. Another very significant difference from the UK case was that the merging parties in the Italian transaction were able to present the Commission with executed agreements with a potential remedy-taker, Illiad SA, during the Commission's review of the main transaction, i.e. a "fix-it-first" remedy structure. As a result, the Commission's clearance decision approved not only the substance of the remedies package but also the identity of the remedy-taker, noting that as a successful entrant to the French telecoms market Iliad "has the know-how and expertise to operate, invest and innovate in the Italian market."[44]

On clearing the Italian transaction, Commissioner Vestager stated that the remedy package accepted by the Commission:

> [s]hows there is no need for a trade-off between competition and growth through consolidation. Telecom companies can grow in Europe by consolidating within the same country, if the conditions are right. They can also grow by expanding cross-border. This is the case for Iliad. It will increase its footprint in another Member State as a new European player. We welcome this.[45]

Interestingly, the Commissioner also said of the Italian merger that:

> One alternative might have been to create or strengthen a virtual operator, which rented space on other companies' networks, to restore competition. But a virtual operator can't help being dependent on the companies that carry its data and its calls. So it's difficult to design agreements that give virtual operators the freedom to really compete. And you risk having to monitor the arrangement for years, to make sure physical operators aren't preventing them

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[43] Case M.7612, at para. 3001.

[44] *Mergers: Commission approves Hutchison/VimpelCom joint venture in Italy, subject to conditions*, European Commission - Press release, September 1, 2016 (available at http://europa.eu/rapid/press-release_IP-16-2932_en.htm).

[45] Statement by Commissioner Vestager on Commission decision to approve Hutchison/VimpelCom joint venture in Italy, subject to conditions, European Commission – Statement, September 1, 2016 (available at http://europa.eu/rapid/press-release_STATEMENT-16-2934_en.htm).

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from competing.[46]

The Commissioner suggests that – in 4:3 MNO consolidations – while the door is not yet entirely closed on NEO remedies based on an up-front capacity and investment commitment, it is currently no more than ajar.

[46] Competition and the Digital Single Market, Speech by Commissioner Vestager, September 15, 2016 (available at http://ec.europa.eu/commission/2014-2019/vestager/announcements/competition-and-digital-single-market_en).

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