MOBILE FIXATION? A REVIEW OF RECENT EC DECISIONS IN THE TELECOMS SECTOR

By Sascha Schubert[1]

I. INTRODUCTION

The EU telecoms sector has gone through several years of intense M&A activity, characterized by horizontal 4:3 mobile consolidation on the one hand and fixed/mobile ("FM") integration on the other. Whether and in which direction consolidation will continue over the coming years depends in part on the prospects of obtaining regulatory clearance. After a series of highly publicized and sometimes controversial European Commission ("EC") decisions, now may be an appropriate time to take a step back and look at the broad themes which are emerging from those cases.

II. HORIZONTAL MOBILE MERGERS: THE END OF 4:3?

The EC has reviewed six 4:3 mergers of mobile network operators ("MNOs") since 2012. All of them were subject to in-depth probes.[2]

The EC did not claim that these mergers would create or strengthen a single dominant position. Rather, it raised non-coordinated effects concerns on the basis of a number of factors, none of which it considered to be individually decisive. Its analysis focused on the closeness of competition between the parties; the extent to which one of them exerted disproportionate competitive pressure despite (or because of) its small market share

[1] Sascha Schubert is a Partner in Freshfields Bruckhaus Deringer's Antitrust, Competition and Trade Group. He is based in Brussels.

[2] These mergers are: *Hutchison 3G Austria/Orange Austria; Hutchison 3G UK/Telefónica Ireland; Telefónica Deutschland/E-Plus; Telenor/TeliaSonera; Hutchison 3G UK/Telefónica UK; Hutchison 3G Italy/WIND/JV.*

BRU8353100/1 PENDING-068550

("important competitive force"); the likely reaction of other competitors to hypothetical price increases by the merged entity; and variations of upwards pricing pressure (UPP) analysis. In its most recent investigations, the EC also found a risk of coordinated effects. At a high level, three aspects are worth highlighting:

First, in line with what can be observed in other sectors, the review of the parties' internal documents has become a key element of the EC's assessment. For example, in its most recent decision in the case of *Hutchison Italy/Wind*, the competitive assessment starts with a 30 page discussion of the parties' internal documents.[3] The internal documents are, quite literally, setting the stage for the remainder of the analysis.

Second, the test for measuring competitive harm as it has been defined by the EC in successive decisions, leaves the EC with significant discretion. This has been criticized by many observers as effectively lowering the threshold for regulatory intervention in merger projects. The EC's recent decision to block the 4:3 mobile consolidation in the UK[4] is under appeal and it cannot be excluded that the EC may have to revisit its approach once the Court has delivered its verdict.

Third, the parties have generally argued that their mergers give rise to efficiencies which outweigh any potential anti-competitive effects. In each case, the EC has rejected this efficiency defense, on the basis that the conditions of the test applied by the EC when assessing efficiency claims were not met. Importantly, the bulk of the savings which can be realized by merging two operators' networks concern fixed costs. The EC has generally disregarded those types of cost savings on the basis of economic theory which suggests that fixed cost savings are unlikely to be passed on to consumers. The EC has also repeatedly rejected the argument that the fixed cost savings would be partly reinvested in order to build more powerful networks. In fact, Commissioner Vestager has made it clear that she sees no link between consolidation and investment.[5]

Against this background, it would be reasonable to expect that, applying the test as defined in recent decisions, the EC is likely to raise concerns about any future 4:3 consolidation in a European mobile market, which would have to be addressed by offering remedies. When comparing the remedies which have been imposed in the successive cases, there is one consistent trend: over time, the remedies have become more and more demanding.

When Hutchison's took over Orange Austria in 2012, the EC was satisfied that any issues would be addressed by Hutchison's offer to grant virtual operators ("MVNOs") wholesale access to its network based on attractive terms.[6] In 2014, the EC cleared mobile mergers in Ireland[7] and Germany[8]. In those cases however, a plain "Austrian-style" MVNO remedy was no longer considered sufficient. While the EC did not insist on market entry by a new MNO, it requested that the acquirers sign up to a special deal: the MVNOs had to acquire

[3] Commission Decision of September 1, 2016 in Case COMP/M.7758 – *Hutchison 3G Italy/WIND/JV*.
[4] Commission Decision of May 11, 2016 in Case COMP/M.7612 – *Hutchison 3G UK/Telefónica UK*.
[5] See, for example, Commissioner Margrethe Vestager's speech, 42nd Annual Conference on International Antitrust Law and Policy, Fordham University, October 2, 2015, available at: http://ec.europa.eu/commission/2014-2019/vestager/announcements/competition-and-digital-single-market_en.
[6] Commission Decision of December 12, 2016 in Case COMP/M.6497 – *Hutchison 3G Austria/Orange Austria*
[7] Commission Decision of May 28, 2014 in Case COMP/M.6992 – *Hutchison 3G UK/Telefónica Ireland*.
[8] Commission Decision of July 2, 2014 in Case COMP/M.7018 – *Telefónica Deutschland/E-Plus*.

30 percent of the merged entity's network capacity upfront. This, according to the EC, created incentives for the MVNOs to compete which were similar to those of an MNO. In the subsequent cases relating to Denmark[9] and the UK,[10] the EC went one step further by insisting on market entry of a fully-fledged MNO. The merging parties were unable to accommodate that request, resulting in the withdrawal of the Danish notification and the prohibition of the UK transaction. Most recently, in Italy, the parties managed to convince a new MNO to enter the market and received EC clearance in exchange.[11] Strictly speaking, the Italian case does not therefore constitute a 4:3 consolidation: two MNOs merge, but another one enters ("4:4 merger").

Despite appearances, Commissioner Vestager has been keen to emphasize the EC's "case by case approach," and has stated that "there is no magic number" of MNOs required to maintain competition in national markets.[12] This seems to imply that the differences between the remedies imposed since 2012 may be explained by differences in the facts of each case, rather than by a change of policy.

It is certainly true that there are distinguishing factors. However, they do not fully explain the different outcomes. This may be illustrated by comparing the key features of the German and the Italian cases. Both concerned a combination of the third and fourth operator in large countries, resulting in a new market leader with a combined share of 30-40 percent. The EC claimed in both cases that the parties were close competitors, and in neither case were network sharing agreements an issue. There were also a number of more subtle differences, however it is not obvious why, on balance, the Italian merger should have been significantly more harmful to competition than the German merger. For example, it seems that MVNO competition was slightly more developed in Germany than in Italy, but on the other hand, based on the EC's findings, the merging parties in Germany seem to have been closer competitors than in Italy. The differences do not seem important enough to explain the paradigm shift from MVNO to MNO remedy.

This suggests that policy changes may have also played an important role. Right from the beginning of the recent EU mobile merger saga, the EC has been faced with a dilemma. Helping to establish high-speed wireless networks is a top EU priority, because they form the "backbone" of the European digital economy. Smaller MNOs have brought a strong case that they need to join forces in order to achieve the scale required to make the necessary investments in their networks and to catch up with larger rivals. While the EC has never formally recognized an "efficiency defense," these arguments may have nevertheless facilitated the earlier clearances, especially in small countries such as Austria or Ireland, where the argument that a fourth operator may be sub-scale seems intuitively compelling. On the other hand, the EC is concerned that a reduction of players below four may result in price effects in what it considers to be oligopolistic markets with high barriers to entry. These concerns were exacerbated by reports about perceived price increases in Austria following the 2012 consolidation. National authorities have been increasingly vocal in their criticism of the EC's practice of clearing 4:3 mergers, culminating in the fierce opposition of the UK

[9] Case COMP/M.7419 – *TeliaSonera/Telenor/JV*.
[10] Commission Decision of May 11, 2016 in Case COMP/M.7612 – *Hutchison 3G UK/Telefónica UK*.
[11] Case COMP/M.7758 – *Hutchison 3G Italy/WIND/JV*.
[12] Commissioner Margrethe Vestager's statements following the withdrawal of the merger planned by Telenor and TeliaSonera.

authorities to the *Hutchison/O2* merger project. These controversies have not been without consequence on the EC's thinking.

As a result, since Commissioner Vestager took over from her predecessor, the EC has become more skeptical towards MVNO remedies. This can be illustrated by public statements. For example, in the EC's merger brief 1/2014, MVNO remedies in the German, Austrian and Irish cases were described as "equally effective" as MNO remedies.[13] In contrast, in a recent speech explaining why MNO entry was considered necessary as a condition for clearing the Italian mobile merger, Commissioner Vestager explained 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 from competing. That's why, in the Italian case, we had a clear preference for a structural solution.[14]

This "preference for a structural solution" is unlikely to be limited to "the Italian case." To put it simply: in order to clear MNO mergers in 4 player markets, MNO entry seems to be "the new normal."

What is the impact of the EC's evolving approach on mobile consolidation in Europe? There are 11 four player markets left in the EU. In many cases, new MNO entry based on a divestment of spectrum and assets will not be possible, either because the merging parties do not have enough spectrum to divest or because such a far-reaching divestment would make the deal economically unviable.

It has been suggested that new MNO entry may in such cases be achieved through network sharing arrangements. However, the effects of network sharing on competition are not necessarily only positive. Each party to the netshare has a veto right over investments. As a result, investment decisions will often correspond to the smallest common denominator: the party which wants to spend less will normally prevail. From that perspective, an MVNO remedy may be better for quality competition than the entry of a network sharing MNO. Indeed, an MVNO remedy allows a new player to access the market without undermining investment competition, because the merged entity can continue to pursue its own network strategy uninhibited by veto rights over investment decisions.

Despite the EC's clear preference for MNO remedies, MVNO remedies have not been entirely excluded. However, the recent decisional practice indicates that they may only be acceptable in very exceptional circumstances. And the EC has yet to explain what such circumstances could look like.

III. FM INTEGRATION: A CLEAR TRACK AHEAD?

[13] European Commission, Competition Merger Brief, Issue 1/2014 – November.
[14] Commissioner Margrethe Vestager's speech, 42nd Annual Conference on International Antitrust Law and Policy, Fordham University, October 2, 2015, available at: http://ec.europa.eu/commission/2014-2019/vestager/announcements/competition-and-digital-single-market_en.

A key driver for FM mergers is the desire to address consumers' increasing appetite for multi-play offers, and the expectation that single-play customers can be converted into multi-play customers, which helps with customer acquisition and retention.

Complainants have argued that the creation of a second integrated player (cable/mobile) in addition to the existing integrated incumbent (DSL/mobile) would result in a market dominating duopoly of integrated FM operators, marginalizing the remaining non-integrated operators. However, in line with the EC's traditional reluctance to intervene in conglomerate mergers, these complaints have not gained much traction. Key conglomerate complaints which have been rejected by the EC include the following:

First, complainants have argued that non-integrated players (MVNOs with a fixed network or mobile-only operators) depend on access to the merging parties' respective (fixed and mobile) infrastructures in order to be able to offer multi-play services, which is crucial for competitiveness. The merged entity would have increased incentives to foreclose non-integrated players from such access.[15] The EC has carefully assessed but so far always rejected such foreclosure concerns. It has stressed the fact that there continue to be MNOs in the market which do not have a fixed network and whose incentives to host fixed MVNOs remain unaffected. Foreclosure of mobile players seeking access to fixed networks was considered implausible, mainly due to the existence of access regulation. Typically, the DSL incumbent has to offer regulated access to its fixed network, and in some countries, such as Belgium, such regulation extends to cable.

Second, it has been argued that non-integrated operators would be hampered by the integrated players' ability to cross-sell mobile services to existing fixed customers or vice versa, thereby leveraging a strong position in one market into another. According to complainants, this advantage would be reinforced by the fact that integrated fixed/mobile players can offer a quality and price which cannot be matched by non-integrated competitors.[16] These types of concerns have essentially been rejected as "efficiency offenses." The EC has found that such competitive advantages for integrated players, should they really exist, would force the non-integrated operators to invest in better products (such as multi-play offers via access to third party infrastructure) or to offer discounts, ultimately benefitting the consumers. This would only not be the case if the competitive advantages of an integrated player would be sufficient to force other players to exit the market or to render them squarely uncompetitive. This very high standard of proof will be difficult to meet for any complainant. In the absence of such extraordinary circumstances, the EC seems to share the notifying parties' view that, far from creating an anti-competitive duopoly, FM mergers are good for competition because they have the potential to increase the constraints on the incumbent integrated player as well as single-play operators.

Since 2013, the EC has reviewed six FM mergers.[17] None of these transactions have been prohibited or subject to remedies which made the parties withdraw the filing, contrary to

[15] Commission Decision of September 20, 2013 in Case COMP/M.6990 – *Vodafone/Kabel Deutschland*, para. 384, 391-392, 396; Commission Decision of July 2, 2014 in Case COMP/M.7231 – *Vodafone/ONO*, para. 179; Commission Decision of May 19, 2015 in Case COMP/M.7421 – *Orange/Jazztel*, para. 809; Commission Decision of February 4, 2016 in Case COMP/M.7637 – *Liberty Global/BASE*, para. 314, 332.

[16] Commission Decision of February 4, 2016 in Case COMP/M.7637 – *Liberty Global/BASE*, para. 359, 364.

[17] These case are: *Vodafone / Kabel Deutschland; Vodafone/ONO; Orange/Jazztel; Altice/Portugal Telecom; Liberty Global/Base; Vodafone/Liberty Global.*

what we have seen in the field of mobile consolidation. Four cases were cleared in Phase 1 (of which two were subject to remedies and two were cleared unconditionally) and two following in-depth probes (in each case subject to remedies). Combining a fixed infrastructure with a mobile infrastructure did not give rise to serious concerns in any of these cases. Where remedies were required, they were designed to remove or reduce any remaining horizontal overlaps, be it in fixed or in mobile. It is noteworthy that the EC is increasingly looking at competition between fixed/mobile bundles on a hypothetical "multi-play market," as opposed to focusing on competition between fixed services or mobile services only. However, again, concerns on the multi-play market have so far only been raised to the extent that there was a horizontal overlap, i.e. where each party had already been offering fixed/mobile bundles pre-merger (such as in *Orange/Jazztel*).[18] The remedy in such cases consisted of divesting (parts of) the horizontal overlap with the effect that the transaction became closer to a "pure" fixed/mobile merger, which did not give rise to any concerns.

In one FM case (*Orange/Jazztel*), the EC has formally recognized the merger efficiencies claimed by the parties, something which is extremely rare in the EC's decisional practice. The parties had argued that the merger would allow them to eliminate variable costs in the form of MVNO wholesale fees which Jazztel would no longer have to pay post-merger because it could be hosted on the Orange network. The EC recognized that these variable costs savings were likely to be passed on to the consumers. This is in stark contrast to the situation in MNO/MNO mergers, where, as mentioned above, the EC has generally rejected the parties' efficiency claims relating to the (mainly fixed) cost savings which can be generated from network integration.

IV. CONCLUSION

The broad themes which seem to be emerging from the EC's recent telecoms decisions are the following: In what can likely only be explained by a policy shift, the EC has become increasingly critical of MVNO remedies in MNO/MNO mergers. As a result, the EC will now typically require the entry of a new MNO as a condition for allowing horizontal consolidation in 4 player mobile markets ("4:4 merger"). In contrast, as regards FM mergers, the EC has so far been by and large unimpressed by complaints, which related to foreclosure or marginalization of non-integrated operators by allegedly supra-competitive duopolies of integrated players. These conglomerate mergers have experienced a much more benign reception, and have even been implicitly welcomed as pro-competitive, subject however to the potential divestiture of any significant remaining horizontal overlaps.

[18] Commission Decision of May 19, 2015 in Case COMP/M.7421 – *Orange/Jazztel*.