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Sir Nicholas Forwood QC
Counsel, White & Case, Brussels
Former Judge, Court of Justice of the European Union - General Court

Katarzyna Czapracka
Partner
White & Case
Brussels/Warsaw

Thilo Klein
Executive Vice President
Compass Lexecon
London/Berlin/Düsseldorf

Mark Powell
Partner
White & Case
Brussels/London

CONCURRENCES LAW & ECONOMICS WEBINARS
The General Court's *CK Telecoms* ruling: Is Three the new magic number?
Towards a re-assessment of unilateral effects in merger review

Webinar – 1 July 2020*

Law & Economics Webinar organised by Concurrences, in partnership with White & Case and Compass Lexecon.

Sir Nicholas Forwood QC

The judgment in the *O2* case has been described as a bombshell. It annulled the Commission's decision prohibiting the merger between several UK telecommunications operators. There was a reduction from 4 to 3 operators in an oligopolistic market, with no reinforcement of a dominant position.

Until the late 1990s, economic assessments by the Commission were a hands-off area in EU judicial review. In 2002, the Commission received a real setback in cases *Airtours*, *Tetra-Laval* and *Schneider*. The Court made it clear that it would carry out a full review and developed a deep and critical analysis of the details of the economic assessments. As a result, Mario Monti appointed a Chief Economist and increased the number of economists within the DG COMP.

"THE JUDGMENT IN THE *O2* CASE HAS BEEN DESCRIBED AS A BOMBSHELL."
SIR NICHOLAS FORWOOD QC

Since then, the grounds for review have been clarified, although all merger assessments are necessarily prospective and imply inherent uncertainty. The Court stated in *UPS* that the chains of likely cause and effect must be examined. The significant impediment to effective competition (SIEC) must be a "direct and immediate" result of the merger, but it is sufficient that the presumed future conduct of the merged entity is "made possible and economically rational" (*Cisco*). The complexity of theories of harm does not affect the standard of proof but will affect the assessment of the likelihood (*Bertelsmann/Sony*). The purpose of examining the possible effects is to identify the "economic outcome

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attributable to the concentration which is the most likely" (*GE*). It is not possible to cumulate a series of different possibilities which each entail a risk of SIEC.

The case-law still left open the questions of the standard of proof: was it a balance of probabilities, a "strong probability" or "sufficiently realistic and plausible"? There was no case law on Regulation 139/2004 prohibition decisions and the introduction of a new test based on non-coordinated effects. Most cases relating to merger control came from clearance decisions, with or without commitments. In *Sun Chemicals* the case was initiated by a complainant, in *Ryanair* and *Cisco* by a competitor, and in *Test-Achat* by consumers.

Mark Powell

The trio of cases — *Airtours*, *Tetra-Laval* and *Schneider*—created a degree of nervousness within the EC about the substantive merger, notably, in relation to coordinated effects. To some extent, the SIEC came to the rescue a couple of years later. The test of 2004 was designed to fill a perceived "gap" in merger control brought to the fore by the US *Baby Foods* case, which concerned a merger between number 2 and number 3 on the market that arguably would have produced negative price effects for consumers, as number 2 and 3 were slogging it out on the market.

The test in the new Regulation was applied with great enthusiasm to an in-country mobile merger, among other things, due to the availability of switching data. Almost all European attempts to consolidate the mobile market fell victim to this theory of harm. In the first three mergers, in Austria, Ireland and Germany, 4-to-3 mergers were permitted but were approved on condition that there be a reinvigorated mobile virtual network operator on the retail market. However, things got much tougher for the merging parties under Commissioner Vestager. The first merger case, *Telia/Telenor* in Denmark, was withdrawn at the last minute, before being blocked. Then, the merger between O2 and Three was blocked in the UK. In an Italian deal, *Wind/Hutch*, the 4-to-3 merger was allowed, but only on the condition that a number 4 would be brought back onto the market. There was a feeling among telecoms executives that there was a magic number, and three was not it.

In the UK case, there were three theories of harm involved: one linked to the retail network, one in relation to network sharing, and one linked to the wholesale market. However, before tackling the three theories of harm, the General Court decided to set the scene. This introductory section of the judgment has implications going far beyond the narrow field of in-country mobile mergers. One of the most far-reaching aspects of the judgment relates to the standard of proof, the test that the Commission needs to satisfy in order to block a merger. This question had surprisingly not hitherto been resolved. In *Bertelsmann*, AG Kokott rejected any standard of proof based on "very probable" or "particularly likely", as this would weaken the Commission's competition policy functions. In *Tetra-Laval*, AG Tizzano used the words "very probable of creating or strengthening a dominant position".

The General Court sided with AG Tizzano and opted for the stricter standard. This is likely to be one of the aspects of the judgment that the Commission will find most concerning. In addition, this standard of proof is not confined to so-called "gap cases". The General Court stated that the standard of proof applicable to non-coordinated effects is not substantially different from that applicable to coordinated effects.

While the complexity of a theory of harm does not have an impact on the standard of proof, the more prospective the analysis is, the higher the quality the evidence needs to be. The General Court clarified that the novelty of a theory of harm is not an issue, recalling the sliding scale: the more fanciful the theory of harm, the more it needs to be backed up with hard evidence. Moreover, the General Court stated that the harm caused in the "gap cases" needs to be equally as damaging as the creation or strengthening of a dominant position.

What does this judgment mean for future cases? There are many open questions. How strong is a "strong probability"? How close is "particularly close" (in the context of the closeness of the merging parties)? What does it mean to "stand out" from the competition (in the context of an analysis of important competitive force)? Does it mean that 4-to-3 mergers will get easy clearance now? The General Court did not say that the Commission cannot prohibit such transactions: it only stated that it cannot do it this way.

Despite the higher burden, the Commission is unlikely to radically change tack with respect to 4-to-3 mergers, and we may see even more extensive requests for information in order to gather the hard evidence that it will need to buttress its prohibition decisions. But clearly the balance has shifted in favour of the merging parties and, accordingly, the Commission is likely to appeal the judgment at hand, which will create a two-year hiatus.

Katarzyna Czapracka

The General Court has tested the Commission's approach to unilateral effects and "gap cases" (*i.e.* cases below the dominance threshold). The judgment recalled the hierarchy of norms, starting with Article 3(2) of the Merger Regulation and the discussion of the SIEC test. Recital 25 EUMR, with regard to "gap cases", has two limbs. On the one hand, the Commission must prove that the transaction would lead to the elimination of important competitive constraints. On the other hand, the Commission must also prove that the transaction will result in a reduction of competitive pressure. The Commission did not follow Recital 25 but the Horizontal Mergers Guidelines (*i.e.* the standard analysis of market shares and concentration levels). Special focus was put on the concept of elimination of an important competitive force and on the closeness of the competition. The Commission developed quantitative analyses of predicted price increases.

Regarding closeness, we are talking here about a market in which everybody is close. In the Commission's view, this in itself did not imply a SIEC. In addition, the concept of elimination of an important competitive force is not necessary to establish that one party is not a competitive force. It is sufficient that it exercises competitive constraints on the market, and that its elimination could lead to a SIEC.

The Commission argued that there is no single definition of an important competitive force. However, it acknowledged that when it comes to the Horizontal Merger Guidelines, the notion of important competitive force alludes to a competitor that exercises an influence on competition which is higher than its market share would suggest. The Court stated that the Commission has confused different concepts (the important competitive force, the important competitive constraint by the merging parties and SIEC). The fact that one of the merging parties exercises a competitive constraint cannot in itself lead to the establishment of a SIEC. The Court stressed that the concept of important competitive force can be established only if the merging competitor stands out from the market. A different interpretation of the concept would mean that any merger in an oligopolistic market could be blocked. Lowering that standard of important competitive force would allow the Commission to prohibit mergers without analysing the important competitive constraints. The Court analysed in detail the qualitative evidence showing that Hutch's role on the market was special. The Commission relied on the various initiatives that were taken by Hutch in introducing free services, and it successfully argued that past conduct is not indicative of the current or future role in the market.

"THE GENERAL COURT HAS TESTED THE COMMISSION'S APPROACH TO UNILATERAL EFFECTS AND "GAP CASES"."
KATARZYNA CZAPRACKA

The concept of the closeness of competition is rooted in the Horizontal Merger Guidelines. The Court made it clear that it is not bound by the guidelines but it recognised that the concept of closeness may be relevant in the context of assessing the first limp that is spelt in Recital 25 (whether the transaction would lead to the elimination of important competitive constraints). The fact that the condition of closeness is met does not necessarily mean that there is a SIEC: that requires the satisfaction of two limbs set out in Recital 25.

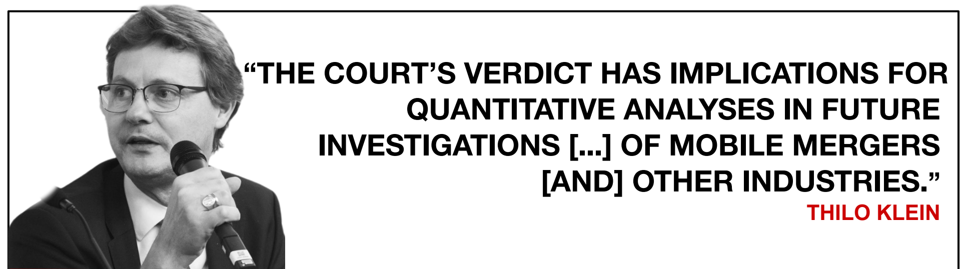
The Court repeated that market shares can only be an indicator of competitive concerns, even if SIEC arises from the creation or strengthening of a dominant position. Highly concentrated markets in the context of "gap cases" do not mean that there is necessarily SIEC. The Court also recognised that there is no "magic number". In the case of a small market share, there is less likelihood of harm to competition. The Court put a higher threshold for the Commission to show closeness, and that the role of the parties on the market could lead to SIEC.

Thilo Klein

The Court's verdict has implications for quantitative analyses in future investigations specifically of mobile mergers, but also of transactions in other industries. In *H3G UK/O2 UK*, the Commission performed the same quantitative analysis that it has run in all mobile cases since *H3G/Orange Austria* (2012). In phase I, it computed indicative price rises ("IPR"), i.e. forecasts of the price increases that the parties may impose once the merger has eliminated the competitive constraints that they used to exert on each other. IPR is a somewhat simplistic model but has the advantage of requiring limited data and is thus particularly suited for a Phase I analysis.

In Phase II, the Commission used a simple calibrated merger simulation developed on the basis of the IPR framework. Unlike the IPR analysis in phase I, the calibrated merger simulation method takes into account that third-party competitors may react to the parties' price increases with increases of their own.

In the absence of merger efficiencies, the Commission's analysis will always predict price increases. There is nothing sinister about this: economists expect mergers of substitutes to create incentives to raise the price. But the predicted price increases of MNO mergers will always turn out to be high. The Commission's model is driven largely by two variables: the diversion ratios between the parties, which will tend to be high in a concentrated industry like mobile telecoms, and the parties' gross margins, which will be high because most of the costs of network operators are fixed. In combination, these two factors drive high price forecasts.



Following the CK Telecoms judgment, the Commission will need to evaluate whether it can still rely on this method in future cases. On the one hand, the Court rejects the complaint that the Commission's method is suitable as a first screen only, holding that this is only true for the phase-I IPR analysis but not for the more sophisticated calibrated merger simulation in phase II. On the other hand, however, the Court notes the statement in the Commission's decision that the analysis "*should not be seen as an exact and precise quantification of the price increases that may result from the transaction, but rather as an 'indication for the likelihood' of such increases*" and concludes that the method, therefore, cannot be relied upon to justify a merger prohibition.

The judgement contains a discussion on the need for a critical threshold for expected merger-induced price increases. The complaint argued that, because the Commission's analysis always predicts price increases, the Commission must assess its results by comparison with a critical threshold above which price increases are considered "significant", which it had failed to do. Unfortunately, the judgement does not provide clear guidance on whether a critical threshold must be defined. On the one hand, the Court accepts that the Commission had failed to show that the predicted price increases were "significant", *inter alia* because it did not explain why in the UK case tougher intervention was merited than previous cases even though the predicted price effects were no higher. The Court thus establishes that the results of quantitative analyses in previous cases constitute a relevant precedent in future assessments. On the other hand, however, the Court stresses that the Commission is not obliged to offer a *de minimis* threshold for predicted price effects.

The Court's stance on efficiencies arguments is little less than revolutionary. An efficiency defence used to be impossible to win. The Commission would always hold that it is on the parties to prove merger efficiencies and require an insurmountably high standard to show that the cumulative conditions of verifiability, merger specificity and benefits to customers are satisfied. The *CK Telecom* judgment may shake up this state of affairs. First, it states that every horizontal transaction generates cost efficiencies as duplicate fixed costs are eliminated. Second, it holds that these efficiencies may well lead to price reductions. This runs counter the conventional wisdom that fixed costs savings are not passed on to consumers. And third, the Court stipulates that these "standard efficiencies" are not subject to the conditions of the efficiency defence; rather, it is for the Commission to take them into account in its competitive assessment and quantitative analyses. ■