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BETTER CONNECTED : EUROPEAN CO-OPERATION IN TELECOMS CASES[1]

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Abstract:

The case study is devoted to the analysis of the European Commission's decision in the Three/O2 UK merger. The case represents a shift in Commission's analysis of telecom mergers. It is also a model example of cooperation between NCAs and the European Commission in merger cases.

Keywords:

merger control, telecom merger, merger prohibition, cooperation between NCAs

Introduction

In 2016 the European Commission took the relatively rare step of blocking a proposed merger – the acquisition of the UK telecom provider O2 UK by CK Hutchison Holdings, the owner of rival telecoms provider in the UK, Three (referred to here as the Three/O2 merger). To be fully understood and appreciated, this decision must be set against the backdrop of several years of consolidation in telecoms markets across Europe, the dissatisfaction of national competition authorities (NCAs) over the Commission's previous decisions in this area and the close co-operation between the Commission, the CMA and other interested NCAs.

1 All views expressed in this article are strictly personal, and should not be construed as reflecting the opinion of the CMA.

This case study explains this backdrop and why the case and the policy changes that ultimately followed it can be seen as a model for co-operation and compromise between regulators.

Telecoms consolidation in Europe – background to the Three/O2 UK merger

The Three/O2 merger came as the latest in a line of mergers between mobile network operators which showed a general trend towards greater consolidation in mobile telecoms markets (already concentrated markets with high barriers to entry) across Europe.

Prior to Hutchison announcing its intention to acquire O2 in the UK, the Commission had cleared (conditionally, having accepted remedies offers) notified mergers between mobile network operators (MNO) in Ireland, Germany and Austria, each of which had reduced the number of mobile network operators from four to three in those countries. The acceptance by the Commission of remedies in these mergers had left many NCAs, including the CMA, uneasy about possible perceptions of leniency on the part of the Commission towards fewer mobile telecoms operators in Europe. There were also concerns that the remedies accepted by the Commission did not fulfil the requisite criteria to render an anti-competitive merger compatible with the common market.

Basic conditions for acceptable remedies

While the burden of proof is on the Commission to prove a finding of a substantial impediment to effective competition (SIEC), it is up to the parties to put forward an offer of remedies and all necessary information to show that the offer meets the conditions set out in the EUMR. These conditions are:

a) The remedies eliminate the competition concerns identified in their entirety;
b) The remedies are comprehensive and effective; and
c) The remedies are capable of being implemented effectively within a short period of time.

It is then for the Commission to determine whether the merger can be declared compatible as a result of the remedies.[2]

In the previous telecoms cases, the Commission had accepted remedies which were intended to enhance the offering of, and therefore competition from, mobile virtual network operators (MVNOs). MVNOs, which are a feature of mobile telecom markets across Europe, provide telecoms services by leasing network infrastructure from MNOs. They were a welcome competitive dynamic in often very concentrated markets with barriers to entry such as the need to acquire significant network infrastructure and the

2 Articles 6(2) and 8(2) of the EUMR (Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, EU OJ L 24, 29.01.2004, p. 1-22. Available from: https://eur-lex.europa.eu/eli/reg/2004/139/oj) expressly provide that the Commission may decide to declare a concentration compatible with the common market after modification by the parties. Such modifications are more commonly referred to as remedies.

authorisation to use spectrum bands. In addition, in piggybacking on established mobile networks, MVNOs may often offer lower prices to consumers. However, in terms of *eliminating* the competition concerns identified from the merger of two MNOs, many thought that an MVNO by its very nature of being reliant on an MNO could not replace the competition lost.

As noted in the Commission's guidance on remedies,[3] the basic aim of remedies is to ensure competitive market structures. Accordingly, remedies which are structural in nature in that they offer a lasting change to the market are preferable. While the remedies in the Austrian, German and Irish cases did include structural elements through the divestment of spectrum and a degree of network capacity, without a network or other relevant assets of their own, there was criticism that introducing new or even enhanced MVNOs would not bring about the necessary lasting change since they remained dependent on the MNOs and lacked the ability and incentives to compete effectively in the longer term.

Indeed by 2016, four years after the Austrian merger was cleared, the MVNO which was the beneficiary of the remedy had only been operating for two years, the full suite of assets offered to the MVNO had never been utilised and the Austrian telecoms regulator found that prices for mobile services had increased.

The Commission was however showing willingness to listen to the criticism and learn from the outcomes of previous cases. A three-to-two case in Denmark (the then newly appointed Vestager's home turf) in 2015 saw the Commission showing more skepticism about the MVNO-based remedy offered by the parties which ultimately lead to the deal being abandoned. Vestager has subsequently been clear that this case was on a pathway to being blocked had the parties not decided to throw in the towel.[4]

In the same month that the parties in the Danish case announced that they were abandoning the deal, the Three/O2 merger was notified to the Commission.

The Three/O2 case

The parties had entered into an agreement for Hutchison to acquire all of the shares in O2 UK from Telefónica. The result of the acquisition would be that both Three and O2 would be solely controlled by Hutchison. The acquisition was notified to the Commission for review under the EUMR in September 2015.

The investigation was detailed and complex and involved the review of a huge amount of internal documents, hundreds of third party requests for information (RFIs) and submissions from rival operators, NCAs and sector regulators across Europe.

3 Commission Notice on Remedies acceptable under Council Regulation (EC) No 139/2004 and under Council Regulation (EC) No 802/2004 (2008/C 267/01), EU OJ OJ C 267, 22.10.2008, p. 1–27, par. 15. Available from: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX-:52008XC1022(01).

4 Speech by Vestager 'Competition in Telecom Markets' delivered at 42nd Annual Conference on International Law and Policy, Fordham University, 2 October 2015.

The Commission had multiple meetings with the parties, third parties, Ofcom and the CMA. Relatively rarely for the Commission, the case team also decided to undertake a consumer survey in Phase 2 of the investigation, employing a third party company to interview 1200 retail customers. This is something that was more common in UK merger investigations (both at Phase 1 and Phase 2) and the CMA was able to offer its assistance in procuring a suitable survey provider and designing the questions. In understanding the UK mobile telecom market, the Commission also drew heavily on information from Ofcom, as well as the CMA's investigation into the merger between British Telecoms (BT) and the mobile network operator EE which the CMA had recently cleared.

Concerns identified

The Three/O2 merger was intended to bring together two of the four MNOs active in the UK, which were EE (which by then was owned by BT), O2, Vodafone and Three. At that time, Three was the smallest MNO by number of users, but carried a significant amount of data traffic. It was known for its data-centric and lower cost deals. The CMA and Ofcom, in particular, considered Three an important challenger to the three more established MNOs, and therefore an important competitive constraint that would be lost as a result of the merger.

Particularly concerning was the existence of two network-sharing agreements between the four MNOs. The aim of such agreements is to share some network elements in order to reduce costs and improve coverage and capacity. Three had entered into a network sharing agreement with EE, while O2 had an agreement with Vodafone. The merger would therefore have allowed the merged entity to straddle both agreements with its competitors, which the Commission found would have impacted its incentives to co-operate and given it the ability to frustrate its rivals.

Remedies

Remedies were discussed but, perhaps learning lessons from the previous conditional clearances, the Commission found them inadequate to address the competition concerns identified. The CMA strongly believed (based on the evidence seen thanks to the co-operative nature of the interaction between the authorities) that the only appropriate remedy was the divestment of either the Three or O2 mobile network business either in its entirety or possibly allowing for limited 'carve-outs' from the divested business. The divestment would have needed to include the mobile network infrastructure and sufficient spectrum to ensure a commercially viable fourth MNO in the UK.

The three remedy proposals put forward by the parties did not go this far, failing to include direct divestment of network infrastructure to a new MNO entrant. Instead, the parties offered to agree network access to a new entrant operator.

As set out in a letter the then CEO of the CMA, Alex Chisholm, wrote to Vestager (which was also published), the CMA was of the strong view that the proposed remedies were incapable of eliminating the SIEC:

> *The proposed remedies are materially deficient as they will not lead to the creation of a fourth Mobile Network Operator (MNO) capable of competing effectively and in the long-term with the remaining three MNOs such that it would stem the loss of competition caused by the merger. In addition, they fail to address concerns arising from the presence of the merged entity in both the network sharing arrangements, including the greater risk of coordination that this brings.*[5]

Short of the full divestment Three's or O2's business, the CMA called for the Commission to block the merger. In May 2016 the Commission announced that it had found an SIEC which was not addressed by the remedies proposed by the parties, and it was therefore prohibiting the merger as it was incompatible with the common market. The Commission's press release noted its strong concerns that UK mobile customers would have had less choice and paid higher prices as a result of the merger, and that the merger would have harmed innovation in the mobile sector.

Lessons learnt – the Italian case

The Commission's prohibition in Three/O2 should not be seen as the Commission ruling out four-to-three telecoms mergers in Europe. Rather, it was a clarification of its thinking (and that of the NCAs that supported it) on how to make such mergers work in order to ensure that telecoms networks across Europe receive the investment they need, without sacrificing the effective competition from a rival MNO.

There was also a lesson to be learnt for parties in approaching remedies discussions. The offering and negotiation of remedies is no doubt a difficult question of strategy for businesses. Offer too much and the clearance can reduce the value of the investment or come at the expense of the benefits the merger was designed to bring to the business and hopefully the market. Offer too little and fail to mitigate the concerns of the regulator, risking a rejection and a prohibition. Like any negotiation there is risk and a who blinks first mentality on both sides. The parties in Three/O2, arguably with reason given the remedies accepted in previous cases, perhaps did not believe that the Commission would go as far as to prohibit a merger rather than accept remedies designed to facilitate and incentivise new MNO entry. However, for those engaged in the case at the time, there was a sense that the parties were unwilling or unable to take seriously the universal messages that were coming from the Commission, the CMA and Ofcom on what was necessary to fix the competition concerns identified. Despite three rounds of remedies offers, which on paper were designed to replicate the MNO competition lost, the parties were unwilling to offer a direct divestment of assets to a new entrant.

5 Letter from Alex Chisholm, Chief Executive Competition and Markets Authority United Kingdom to Commissioner Margrethe Vestager, European Commission from 11 April 2016. Available from: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/515405/CMA_letter_to_Commissioner_Margrethe_Vestager.pdf#page24.

Despite some publicity, the Danish case had perhaps not provided clarity of the Commission's position. The Three/O2 prohibition certainly did. The next parties to approach the Commission with remedies to fix a SIEC in a four-to-three telecoms merger, this time in Italy, did not misunderstand the Commission (or else were in a better position commercially to offer structural remedies) and achieved a conditional clearance with a remedy offer which included the divestment of individual parts of each party's telecom's networks, including spectrum, mobile base station sites and network access. Unlike in the UK case, the parties also produced executed agreements with remedies takers – a fix it first approach which satisfied the Commission that the entry of a new MNO was likely enough to be implemented.

Co-operation with the European Commission

The Commission's case team on Three/O2 was a model of pro-active engagement and openness with both the CMA and Ofcom, which lasted from pre-notification to final decision.

Counter-intuitively perhaps, the UK's forth coming vote on leaving the European Union may have assisted relations. Uncertainty over which way the vote would go (and ultimately dashed hopes that it would go one way rather than the other) perhaps encouraged the Commission to demonstrate that it takes concerns of Member States seriously. On the CMA's part, it was particularly open and forthright about their concerns over the merger from very early on. The referral request mechanism under Article 9(2)(a) was also used by the CMA as a tool to signify their significant interest in the case, highlight the probable competition concerns and apply a degree of pressure on the Commission to engage with the CMA.

Power of working together – making Member States' opinions matter

The CMA was also able to call on the support of other NCAs, notably Germany, Austria and Italy, to drive home the real risks arising from consolidation in the market. This proved valuable in supporting the Commission's emerging concerns, providing detailed market knowledge from jurisdictions where consolidation had already occurred and presenting a united front at the Advisory Committee stage.

Reflections and conclusion

The Three/O2 investigation demonstrates the coming together of NCAs, national sector regulators and the Commission to clarify thinking on mobile telecom market consolidation in Europe, both in regards to competition concerns and how they may be remedied. Despite the complexities of the market, the well-resourced parties and the large amount of information and data the co-operation was detailed, close, productive and effective and perhaps represented the high point of co-operation between the CMA and the Commission.

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The author notes that since the time of writing, the General Court has annulled the Commission's decision to block the Three/O2 merger. The General Court found that the Commission had not proved the effects of the merger to the sufficient legal standard and had not shown, based on the evidence, that the merger would result in a significant impediment to effective competition. The Commission has appealed the judgment.