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ALERT MEMORANDUM

The General Court Raises The EC's Bar For Mergers In Concentrated Markets

July 3, 2020

In a landmark Judgment delivered on May 28, the General Court overturned the European Commission's 2016 prohibition of the *Three/O2* UK mobile telecommunications merger. The Judgment raises the bar for the Commission in respect of (1) the legal standard the Commission must meet; (2) the closeness of competition between merging parties required to challenge a merger on a unilateral effects theory of harm; and (3) how the Commission must account for efficiencies in quantitative modelling. Although certain of the Court's findings are specific to the underlying transaction, the Judgment is likely to have important implications for European merger control beyond the telecommunications sector.

The merger involved concentrated markets in which the Commission did not allege the creation or strengthening of single-firm or collective dominance, but instead pursued a unilateral effects theory of harm arising from the loss of competition between the merging companies. The Judgment's primary objection is that the Commission merely showed that Three was an important competitor—which is necessarily the case for all competitors in concentrated markets—without going further to demonstrate that the merging companies were "particularly close competitors" and that their combination would *significantly* impede effective competition.

On one hand, the fact that the Judgment raises the bar for the Commission may make it easier for parties to achieve clearance for mergers in concentrated markets, in particular "4 to 3" mergers. On the other hand—and quite apart from the fact that the Commission will likely lodge an appeal—the Judgment will likely lead the Commission to increase the intensity, burden, and length of its investigations to meet the heightened standards prescribed by the General Court.

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I. Introduction

The Judgment[1] is only the sixth time that the EU courts have annulled a prohibition decision[2] and the first occasion on which the EU courts have considered the new substantive test contained in the recast EU Merger Regulation that came into force in 2004 (the "EUMR"). That test is most relevant to the review of mergers between non-dominant competitors in oligopolistic markets.

a. Factual background

At the time of the merger, the mobile telecommunications market in the UK was mature, with nearly all adults having a mobile device and many having more than one.[3] However, as only 66% of adults owned a smartphone, growth in smartphone plans was expected to continue.[4] Data usage per subscriber was also growing exponentially.[5]

Faced with the cost pressures from rapidly growing consumption (which required significant increases in network investment), Hutchinson 3G UK Ltd., which offered mobile telecommunications services in the UK under the brand "Three", proposed in 2015 to acquire Telefónica Europe Plc, which also offered mobile telecommunications services in the UK under the brand "O2".[6] At the time, there were four mobile network operators ("MNOs") in the UK: BT/EE with roughly 30–40% of subscribers; O2, with roughly 20–30% of subscribers; Vodafone, with roughly 10–20% of subscribers; and Three, with roughly 10–20% of subscribers.[7]

MNOs are providers of mobile telecommunications services that own a network. By contrast, mobile virtual network operators ("MVNOs") sell mobile telecommunications services at retail, but purchase the underlying network services from MNOs under long-term wholesale contracts. A number of MVNOs were active in the UK market, representing less than 10% of subscriber revenues.[8]

In addition to having different-sized subscriber bases, the MNOs in the UK were differentiated by network quality. BT/EE had gained an early lead in 4G technology in late 2012, and remained significantly ahead of the other carriers in 4G coverage at the time of the merger.[9] By contrast, Three was the last carrier to deploy 4G technology and significantly lagged the other carriers in network quality.[10] The carriers also differed in terms of owned spectrum amounts—which are closely linked to network capacity and speed—BT/EE had roughly 255 MHz; Vodafone, 176 MHz; O2, 86 MHz; and Three, 90 MHz.[11]

Three was the last MNO to enter the UK market in 2003. It had introduced a series of innovative measures starting in 2007 to increase the size of voice and data bundles and to price aggressively.[12] It had steadily improved its services and introduced unlimited data in December 2010.[13] Other MNOs eventually followed, with EE offering its own unlimited data plan in January 2012 and O2 and Vodafone following more slowly.[14] Similarly, although all three other MNOs had imposed a premium charge for 4G, once Three was finally able to deploy 4G in 2013, it did not do so.[15] The Commission also found that Three pursued an aggressive pricing policy at the time of the merger.[16]

The merging parties contended that, notwithstanding its success in attracting subscribers, Three was facing

[1] Judgment of 28 May 2020, *CK Telecoms UK Investments Ltd v. Commission*, Case T-399/16, EU:T:2020:217 ("Judgment").

[2] *See* Case T-342/99 *Airtours v Commission* EU:T:2002:146; Case T-310/00 *MCI v Commission* EU:T:2004:275; Case T-310/01 *Schneider Electric v Commission* EU:T:2002:254; Case T-5/02 *Tetra Laval v Commission* EU:T:2002:264, upheld on appeal in Case C-12/03 P *Commission v Tetra Laval* EU:C:2005:87; and Case T-194/13 *United Parcel Service v Commission* EU:T:2017:144, upheld on appeal in Case C-265/17 P *Commission v United Parcel Service* EU:C:2019:23.

[3] Case COMP M.7612 – *Hutchinson 3G UK / Telefónica UK* ("Commission Decision"), ¶ 60.

[4] Commission Decision ¶ 60.

[5] Commission Decision ¶ 61 fig. 6.

[6] Judgment, ¶ 1.

[7] Judgment ¶ 2.

[8] Judgment ¶ 3; Commission Decision ¶ 343 fig. 19.

[9] Commission Decision ¶ 57.

[10] Commission Decision ¶¶ 56–57 & fig. 4.

[11] Commission Decision ¶ 132 fig. 9.

[12] Commission Decision ¶¶ 492–93.

[13] Commission Decision ¶ 498.

[14] Commission Decision ¶¶ 509–18.

[15] Commission Decision ¶¶ 567–69

[16] Commission Decision ¶ 624.

imminent capacity constraints that would raise its costs, reduce its network speeds,[17]and limit its competitiveness going forward.[18]

By contrast, the parties argued that the transaction would allow them to realize significant network and scale efficiencies that would allow them to compete more effectively.[19] By combining the parties' networks, they could make more widespread use of each party's spectrum on the other's towers; by allowing devices to connect to multiple frequencies at once, they could carry more data on the spectrum they already had; and by combining certain minimum-sized blocks of spectrum to support legacy devices (e.g., 3G), they could move spectrum to more efficient newer standards (e.g., 5G).[20]

The parties also argued that these efficiencies (in particular the ability to place spectrum on each other's towers) would result in significant marginal cost savings.[21]

Finally, the parties argued that these network efficiencies would allow the combined firm to deliver higher speeds to customers, increasing the quality of the services received.[22]

In support of these efficiencies, the parties submitted a version of the capacity model that Three used to plan its network.[23]

To address potential concerns of the Commission, the parties committed to: (1) divest O2's stake in the MVNO Tesco Mobile; (2) perpetually divest 10–20% of the capacity of the combined network to a new entrant for an annual lump sum (to ensure it had low marginal costs); and (3) extend 4G services to MVNOs for the next 5–10 years at the same rates O2 was currently charging for 3G services.[24]

b. The Commission's decision

The Commission noted that the parties' market shares would give the combined entity a "*strong position*" in the retail market, but did not assert that the transaction would create or strengthen a dominant position.[25] It concluded, however, that due to the low number of MNOs active in the UK and the distribution of their subscriber shares, the market was already concentrated before the transaction and would become even more so afterwards.[26] The Commission considered Three to be more important to competition than its market share indicated, in particular because of its history of introducing unlimited data and of not charging a premium for 4G.[27] The Commission considered MVNOs as having limited competitive significance because of their higher costs and inability to differentiate themselves from MNOs based on network quality.[28]

As noted, the Commission focused its theory of harm on unilateral effects—that is, the concern that the combined entity would unilaterally be able to raise prices post transaction, when neither party would have been able to do so pre-transaction because enough customers would have switched away to the other party to make a price increase unprofitable. To assess potential unilateral effects concerns, the Commission focused initially on qualitative information. First, the Commission carried out a survey as part of its market investigation.[29] The majority of respondents in that survey generally indicated that EE was the closest competitor to Three, but a significant number also mentioned O2, and very few mentioned Vodafone.[30] Second, the Commission reviewed the parties' internal documents.[31] The Commission acknowledged that, in addition to discussing one another, the merging parties' documents also discussed and monitored EE, Vodafone, and, to a certain extent, MVNOs.[32] The

17 Commission Decision ¶ 683.
18 Commission Decision ¶ 865.
19 Commission Decision ¶ 2337.
20 Commission Decision ¶¶ 2368–2376.
21 Commission Decision ¶ 2423.
22 Commission Decision ¶ 2425.
23 Commission Decision ¶ 2422.
24 Commission Decision ¶¶ 2620, 2625, 2649; The parties also committed to continue a network-sharing obligation with competitors that was the subject of a separate theory of harm. Commission Decision ¶ 2620.
25 Commission Decision ¶ 406
26 Commission Decision ¶ 406
27 Commission Decision ¶¶ 519, 568, 572.
28 Commission Decision ¶ 1148.
29 Commission Decision ¶ 413.
30 Commission Decision ¶ 413.
31 Commission Decision ¶ 418.
32 Commission Decision ¶ 423.

Commission therefore concluded that the parties competed closely, but were not closest competitors.[33]

As a second step, the Commission examined quantitative evidence. First, it assessed customer switching behaviour based on consumers porting their phone numbers between carriers.[34] Second, because some consumers do not port their numbers, the Commission also carried out a more extensive consumer survey.[35] This showed that, in the event of a price increase, roughly 10–20% of O2's postpaid and 20–30% of O2's prepaid subscribers would switch to Three; while 30–40% of Three's postpaid and 40–50% of Three's prepaid subscribers would switch to O2.[36] In general, the survey data showed that EE and Vodafone would capture more subscribers from O2 than would Three, but that O2 would capture more of Three's subscribers than would the others.[37] The Commission concluded that this reinforced that the parties were close competitors.[38]

Based on these switching data, the Commission conducted an econometric merger simulation that endeavoured to measure the "upwards pricing pressure" resulting from the merger: Pre-merger any price increase by the parties would have resulted in some number of customers switching to the other party (thus dis-incentivising either party from raising prices). By removing the other party as a close competitor, the transaction would have reduced the number of customers who would switch away in response to a price increase and increased the profitability of any price increase.

The increased incentive (or reduced dis-incentive) to raise prices post transaction is often referred to as the "gross upward pricing pressure". The index which measures this pressure is known as the GUPPI.[39] It is a direct function of the entity's gross profit margin and the share of customers who would have switched to the other party but would no longer do so given the transaction.

In conducting a merger simulation based on this GUPPI analysis, the Commission concluded that the parties were likely to raise prices by roughly 6–11% on average across all segments and sensitivities the Commission considered.[40]

While, as one would expect, the parties' gross margins were a critical input for these results, the Commission only considered short-run network costs, and disregarded costs from sales and distribution, as well as the parties' claims that their network costs would rise in the future; this arguably overstated the margins and thus any GUPPI.[41] These results also did not account for countervailing downward pricing pressure that remedies, entry, repositioning, or efficiencies were likely to yield.[42]

As noted above, the parties argued that Three and O2 were less significant competitors than their shares otherwise suggested due to the impending capacity constraints (and thus, higher costs) that they faced.[43] The parties argued that, by combining their networks, their marginal network costs would effectively be zero for several years, resulting in significant efficiencies that would be passed on to consumers through lower prices.[44]

Although the Commission recognized the general outline of the parties' efficiencies arguments, it concluded that the efficiencies were not verifiable.[45] In particular, the Commission cited internal documents and responses from its market test to suggest that neither Three nor O2 would suffer a

33 Commission Decision ¶ 438.

34 Commission Decision ¶ 445.

35 Commission Decision ¶ 447.

36 Commission Decision ¶ 456 & fig. 38.

37 Commission Decision ¶ 456 & fig. 38.

38 Commission Decision ¶ 463.

39 *See* Joseph Farrell and Carl Shapiro, Antitrust Evaluation of Mergers: An Economic Alternative to Market Definition, 10 The B.E. Journal of Theoretical Economics 1 (2010); Steven C. Salop, Serge X. Moresi, and John R. Woodbury, Scoring Unilateral Effects with the GUPPI: The Approach of the New Horizontal Merger Guidelines (Aug. 31 2010).

40 Commission Decision ¶¶ 1209–10, 1224.

41 Commission Decision ¶ 1202, Appx. A ¶¶ 127, 133.

42 *See* Commission Decision ¶ 1197.

43 Commission Decision ¶¶ 468–73.

44 Commission Decision ¶ 2423.

45 Commission Decision ¶ 2466. The Commission also argued that the parties could have obtained the same efficiencies through a network-sharing agreement, although it did not really grapple with the practicalities of doing so given the parties existing business arrangements, and it ultimately left the question open. Commission Decision ¶ 2487.

significant deterioration in competitive position for the foreseeable future.[46]

Finally, the Commission rejected the parties' commitments. The Commission expressed doubts about whether O2 could realistically divest its stake in the Tesco Mobile MVNO.[47] The Commission also rejected an offer to divest capacity in the network, because it would lead the new entrant to depend on the combined firm in the long-term, with capped capacity.[48] The Commission re-estimated its simulation based on the commitments and found that it reduced the price increase to only about 5–7%.[49]

Although the merging parties pointed to similar commitments being accepted in previous cases, the Commission rejected these references as a matter of principle, stating that "*an applicant is not entitled to call the Commission's findings into question on the ground that they differ from those made previously in a different case, on the basis of a different notification and a different file, even where the markets at issue in the two cases are similar, or even identical*".[50] The Commission also pointed to difficulties in implementing past remedies and to differences in facts between the cases.[51]

Similarly, although the merging parties pointed out that the average predicted price effects for this case (at most 7%) fell between those of two cases previously cleared with remedies (6.6% and 9.5%), the Commission noted that price effects were only one element to be considered in the assessment.[52]

II. Similarities with past telecoms decisions

The Commission has previously reviewed and cleared many telecoms mergers, several of which involved similar fact patterns and similar remedies.

The Commission's explanation of its changed approach was based largely on its view that the remedies in the Irish (*Three/O2 Ireland*)[53] and German (*O2/E-Plus*)[54] "4 to 3" mergers of MNOs had failed,[55] although an econometric study cited in the Judgment calls this premise into question.[56] In any event, the facts in *Three/O2* and the prior clearances appear similar in important respects.

Market maturity. In all three cases, the markets were highly mature, with mobile penetration exceeding 100% (122% in Ireland, 136% in Germany and 132% in the UK).

Market concentration. All three markets were highly concentrated. The four MNOs held a market share in the overall retail market of 90% in Ireland, 80% in Germany, and over 90% in the UK. The post-transaction HHI on the overall retail market would have been almost 3,500 in Ireland (delta: more than 620 points), over 2,400 in Germany (delta: more than 400 points) and over 3,000 in the UK (delta: more than 500 points).[57]

Limited countervailing effects from non-MNOs. In all three cases, the Commission assessed the potential countervailing competitive constraints exercised by MVNOs, Service Providers, and other non-MNO players. Given the dependency of these entities on MNOs for wholesale access, the Commission dismissed potential countervailing

[46] Commission Decision ¶¶ 777, 870.
[47] Commission Decision ¶ 2796.
[48] Commission Decision ¶ 2757.
[49] Commission Decision ¶ 2946.
[50] Commission Decision ¶ 3044.
[51] Commission Decision ¶¶ 3049–55.
[52] Commission Decision ¶ 3059.
[53] Case COMP/M.6992 – *Hutchison 3G UK/Telefonica Ireland* (the "Irish case").
[54] Case COMP/M.7018 – *Telefonica Deutschland/E-Plus* (the "German case").
[55] Commission Decision ¶¶ 3049–55.
[56] Judgment ¶¶ 280–81. In *Three/O2 UK*, the Commission rejected the parties' argument that a plethora of economic studies of developments in other mobile telecommunications markets provides compelling evidence that mobile consolidation would be procompetitive. In the Commission's view, methodological issues and limited availability of data, together with heterogeneous level of market concentration, limited the usefulness of such comparisons, to which it ultimately did "not give significant evidentiary weight." Commission Decision, Annex B.
[57] In addition, in all three cases, the Commission examined and ultimately dismissed potential anti-competitive effects due to spectrum holdings.

effects irrespective of the number of MVNOs, their market shares, and the level of MVNO price competition driving behaviour of non-MNOs.[58]

Target company as the market challenger. All three cases involved the combination of the number two or three in the market (O2) and the number four (Three and E-Plus). The latter—Three (in the UK and Ireland) and E-Plus (in Germany)—were the most recent entrants with lower network coverage and often belated 4G roll-out compared to their rivals, which meant they could not compete on parameters such as network quality and brand image.[59] Instead, they competed on price, offering innovative products such as particularly low-priced packages (Three in Ireland and the UK) or "all-net flat" tariffs (E-Plus in Germany). Their shares had been growing prior to the merger despite a general slow-down of overall market growth.

Internal documents. If anything, the documentary record in the UK case appeared to be better for the parties than in the Irish and German cases. In the UK case, the Commission pointed only to a heavily redacted, but presumably unhelpful, O2 document, while recognizing that O2 would not be operating the combined company.[60] In the Irish case, by contrast, the merging parties' internal documents predicted the transaction would lead to "*market repair*", which the Commission interpreted as an intent to increase prices and prediction that competitors would follow those price increases.[61] And in the German case, the Commission cited internal documents discussing a change to the combined firm's strategy to avoid attacking competitors in high-value segments.[62]

Closeness of competition. In each case, the Commission found the parties to be "close competitors". That said, in the UK case the evidence seemed to affirmatively point to other competitors being closer. The Irish case seemed to conclude similarly, with one of the parties more quality focused and other more price focused.[63] In the German case, by contrast, the Commission's brand study identified the parties' brands as the closest substitutes for one another,[64] and the Commission cited internal documents showing that the parties monitored one another particularly closely, relative to other competitors.[65]

Predicted price effects from a quantitative model. In the UK case, the Commission calculated that the parties were likely to raise prices by roughly 7% on average across all segments.[66] That was higher than the predicted price effects in the Irish case (6.6%),[67] but lower than in the German case (9.3%).[68]

Efficiencies. In none of the cases did the Commission accept the parties' efficiency arguments. The parties repeatedly claimed capacity and quality improvements, expedited technology roll-out (such as new 4G deployment), lower investment costs, and other efficiencies, none of which passed the Commission's high bar. The Commission systematically rejected efficiency claims for lack of verifiability, merger specificity, and unlikely consumer benefit.[69]

[58] The number of MVNOs was the highest in the UK, evidencing the high level of price competition: four in Ireland, four in Germany, and six in the UK (excluding other non-MNOs). The total share of non-MNOs (including Service Providers and Branded Resellers) at provider level was less than 10% in Ireland, 10-20% in Germany, and 10-20% in the UK, in terms of subscribers.

[59] In Germany, the Commission found that the merging parties' networks (so-called "*E-Netze*") were perceived of being of lower quality than the networks of the incumbents Deutsche Telekom and Vodafone (so-called "*D-Netze*"), which given the importance of network quality as a differentiating factor, the Commission took as another indication of the parties' closeness of competition, *see* German case ¶ 292.

[60] Commission Decision ¶ 904.

[61] Irish case ¶¶ 572–74.

[62] German case ¶¶ 489, 542 et seq.

[63] Irish case ¶¶ 44, 49, 60, 65.

[64] German case ¶¶ 297–98.

[65] German case ¶ 312.

[66] Commission Decision ¶¶ 1209–10, 1224.

[67] Commission Decision ¶ 3058 fig. 137.

[68] Commission Decision ¶ 3058 fig. 137.

[69] A recurrent criticism voiced by the Commission was that fixed cost savings would be unlikely to be passed on to consumers in the form of lower prices, while the merging parties argued the pass-on would occur in the form of additional investments. *See, e.g.*, Irish case ¶ 786 et seq.

In the Irish case—with the lowest predicted price effects—the Commission accepted that the merger could plausibly lead to greater rural coverage, but disagreed that this could outweigh the adverse effects of losing a competitor.[70] Observing low pre-merger costs and spare capacity, it doubted additional capacity would have much consumer benefit.[71] By contrast, the Commission accepted that the German case would likely lead to lower marginal network costs and higher network quality, but complained more about the lack of reliable measures.[72] It also saw network sharing as a reasonable alternative.[73]

Remedies. The remedies across the three cases were also similar in their focus on introducing an MVNO with low marginal costs and the eventual potential to enter as a full MNO. In the Irish case, the Commission accepted a remedy that would provide two MVNOs with wholesale access to the combined firm's network under a "capacity model", where they paid a fixed fee for a predetermined fraction of the network's capacity several years ahead, with some possibility for expansion up to a maximum of 15% of the network's capacity.[74] The commitments also allowed for spectrum purchase should one of the MVNOs wish to enter as an MNO.[75] In the German case, the parties offered to conclude an agreement with a newly entering MNO, including a lease of spectrum, national roaming services until it had rolled out its own network, access to sites, and retail outlets.[76] As a backstop, the parties also offered a similar "capacity model" as in the Irish case.[77]

III. Key aspects of the Judgment

Although the Judgment touches on a number of important issues in merger review, a pervasive theme throughout is the Court's view that the Commission erred in simply assuming that fewer competitors necessarily leads to significantly less competition, an assumption that, if left unchecked, would permit the Commission to prohibit virtually any transaction in an already-concentrated market.[78]

a. Raising the standard of review for Commission decisions

In opening, the Court reaffirmed that the General Court has an obligation to conduct "*an in-depth review of 'all elements of Commission decisions'*", including by re-reviewing evidence submitted during the Commission's process.[79] The Court further noted that this duty extends to cases where the Commission has made complex assessments, [80] concluding that "*the more a theory of harm advanced…is complex or uncertain…the more demanding the Courts of the European Union must be as regards the specific examination of the evidence submitted by the Commission*".[81]

The Court followed through on this standard by examining the Commission's evidence in detail and comparing it to what it concluded was the economic consensus (in particular, an econometric study regarding past telecoms mergers).[82] The Court also engaged in an in-depth comparison of the Commission's conclusions in this case against past clearance decisions.[83]

Perhaps more importantly, and separate from the duty to closely scrutinize the Commission's evidence, the Court raised the standard that the Commission must meet to discharge its burden of proof. The Court started by recalling that merger analysis requires the Commission to "*envisage various chains of cause and effect with a view to ascertaining which of them are most likely*".[84] In doing so, the Court required the Commission to "*produce sufficient evidence to demonstrate with a <u>strong probability</u>*" that a concentration gives rise to harm, expressly noting that this lies between a balance of probabilities test and a requirement of proof beyond reasonable doubt.[85]

70 Irish case ¶ 865 *et seq.*
71 Irish case ¶ 553.
72 German case ¶¶ 1057 (network quality), 1090 (incremental costs).
73 German ¶ 1113 et seq.
74 Irish case ¶¶ 976, 982, 985.
75 Irish case ¶ 1000.
76 German case ¶ 1359.
77 German case ¶¶ 1368–77.
78 E.g., Judgment ¶ 171.
79 Judgment ¶¶ 72–73.
80 Judgment ¶ 76.
81 Judgment ¶ 111.
82 Judgment ¶ 280.
83 *E.g.*, Judgment ¶¶ 183, 186, 273.
84 Judgment ¶ 108.
85 Judgment ¶ 118.

This finding appears to depart from jurisprudence of the EU courts that had prescribed a balance of probabilities test. In *Bertelsmann and Sony*, the Court of Justice set a balance of probabilities standard, noting that the Commission is "*required to adopt a position, either in the sense of approving or of prohibiting the concentration, in accordance with its assessment of the economic outcome attributable to the concentration which is most likely to ensue.*"[86]

In *Cisco and Messagenet*, the General Court followed that judgment in stating that the standard is the same for both clearance and prohibition decisions—which would be incompatible with a standard of proof that was anything other than a balance of probabilities test.[87]

The Judgment appears to depart from this jurisprudence, in harking back to an argument raised by Advocate General Tizzano in *Tetra Laval*, that the "*interest of the undertakings seeking to make the merger must prevail*" unless the Commission is able to demonstrate that the transaction "*would very probably lead*" to competitive harm.[88] Although not addressed in the Court of Justice's judgment in that case, the General Court in *Energias* had later explained that the Commission cannot "*sit on the fence*" and prohibit a merger merely because it has doubts.[89] Similarly, Articles 16 and 17 of the European Charter of Fundamental Rights confirm that parties have the freedom to conduct business and the right to property, subject only to being regulated by law in so far as is necessary for the general interest.[90]

b. Requiring the Commission to demonstrate the merging parties are "particularly close competitors"

In the Judgment's section on unilateral effects, the Court most clearly articulated its concern that any oligopoly would satisfy the Commission's asserted standard.[91] On that basis, the Court rejected the Commission's argument that it need only demonstrate that the parties are close competitors.[92]

The Court first considered the EUMR's Recitals to conclude that the Commission must meet two cumulative conditions to find harm in an oligopolistic market: (i) the elimination of important competitive constraints that the merging parties exert on each other; and (ii) a reduction of competitive pressure on the remaining competitors.[93]

Here, the Court made clear that the Commission cannot merely rely on a transaction eliminating an "*important competitive force*" in the market generally, as that would be true for almost any merger in an oligopolistic market.[94] The Court instead noted that the relevant standard is whether the merger eliminates an "*important competitive constraint*" on one of the merging parties, which requires an analysis of the constraints that the merging parties actually exerted on each other.[95]

The Court then dismissed the specific evidence that the Commission had adduced to paint Three as a uniquely aggressive and innovative competitor market-wide. Contrary to the Commission's conclusions, the Court found there was nothing unusual in the fact that a small operator applies lower prices in some segments and that it gains additional customers over time; and that Three's former role as an aggressive force looking to buy entry was irrelevant to the constraint it exercised at the time of the Decision, as it had implemented a "*major strategy shift*" from price-led to brand-led competition three years earlier.[96]

Turning further to the Commission's evidence of the constraints the parties imposed on one another, the Court accepted that closeness of competition is useful in assessing whether a concentration would eliminate an important competitive constraint[97]

86 *Bertelsmann and Sony Corporation of America v Impala*, Case C-413/06 P EU:C:2008:392, ¶ 52.
87 *Cisco Systems Inc. and Messagenet SpA v. Commission*, Case T-79/12 EU:T:2013:635, ¶ 46.
88 Opinion of Advocate General Tizzano, *Commission v. Tetra Laval BV* Case C-12/03 P EU:C:2004:318, ¶ 79.
89 Case T-87/05, ¶ 64. [Fix cite.]
90 European Charter of Fundamental Rights, O.J. C 303/17, arts. 16, 17.
91 Judgment ¶ 249.
92 Judgment ¶ 249.
93 Judgment ¶ 96.
94 Judgment ¶ 97.
95 Judgment ¶¶171–75.
96 Judgment ¶ 220.
97 Judgment ¶ 241.

(despite not being mentioned in the EUMR). [98] But it insisted that the Commission must find merging parties to be "*particularly close competitors*", and noted that, by the Commission's admission, the evidence relied upon fell short of being able to support such a finding.[99]

c. Quantitative models must account for standard efficiencies

Finally, in analysing the Commission's quantitative model, the Court disapprovingly noted the Commission's admission that its merger simulation model would predict a price increase in any horizontal merger, absent accounting for any efficiencies.[100] The Court also noted that the Commission rejected any corresponding concept of a *de minimis* threshold for these price effects to contextualize how high a predicted effect might need to be to raise a concern.[101] The Court further observed that the Commission had cleared the Irish and German cases despite conducting similar exercises in those cases with slightly lower and higher predicted price effects.[102]

The Court was thus unsatisfied that the Commission had discharged its obligation "*to set out clearly and succinctly the decisive facts and legal and economic considerations*" and to follow logical reasoning without any internal contradictions.[103]

Instead, the Court found the need for some limiting principle on quantitative models, grounded in the Commission's obligation to establish the increase predicted by the model "*with a sufficiently high degree of probability*" and "*take into account all the relevant factors which may affect the price level*" as part of the Commission's analysis of competitive effects.[104]

In this respect, the Court noted that nearly every merger would give rise to some efficiencies from rationalising and integrating production and distribution processes,[105] and considered that these "*standard efficiencies*" are relevant component of quantitative models.[106] In doing so, the Court appeared to distinguish between the relevance of efficiencies for modelling exercises, and other efficiency arguments that might be subject to more rigorous scrutiny under the framework of the Commission's Horizontal Merger Guidelines.[107]

IV. To the Court of Justice?

As noted, the Commission is highly likely to appeal the Judgment to the Court of Justice. Although the outcome of any such appeal is necessarily uncertain, we consider below aspects of the Judgment that seem most vulnerable to challenge, as well as those that we would expect the Court of Justice to uphold.

a. The standard of proof required of Commission decisions

Given the established precedent of the EU courts described above, we think the Judgment is vulnerable in raising the standard of proof from a balance of probabilities test.

On the other hand, we would expect the Court of Justice to recognize the concern articulated by the General Court that Commission decisions must be guided by a sufficient quantity and quality of evidence, such that there is some reasonable certainty about the outcome.

We would also expect the Court of Justice to agree that the greater uncertainty or complexity in a Commission decision, the stronger must be the evidence needed to sustain an adverse finding.

b. The closeness of competition that must be shown

The Court appeared troubled that the Commission had demonstrated only that the merging parties were close competitors, but were not particularly close competitors. The Court's central concern seemed to be that, because all competitors in an oligopoly will have meaningful impacts on one another, the Commission would be able to prohibit a merger

98 Judgment ¶ 234.
99 Judgment ¶ 242.
100 Judgment ¶ 263.
101 Judgment ¶ 272.
102 Judgment ¶ 262.
103 Judgment ¶¶ 120–21.
104 Judgment ¶ 275.
105 Judgment ¶ 277.
106 Judgment ¶ 279.
107 Judgment ¶ 279. In explaining these standard efficiencies, however, the Court makes the common error that the extent to which a transaction will lead to efficiencies depends on external competitive pressure.

based on the existence of an oligopoly alone, absent a requirement for the Commission to demonstrate that the merging parties are particularly close competitors.

This concern may be misplaced. As a matter of economics, the merging parties need not be particularly close competitors in order for a merger to lead to harm. It is only required that, given the merging parties' margins, the diversion ratios between the merging parties be sufficiently high, and the effect of remedies, entry, repositioning, and efficiencies be sufficiently low. For example, in a four to three transaction, if the merging parties' gross margins are around 30%, then even if all competitors are equally close and have equal shares, applying the basic GUPPI analysis (not taking into account remedies, entry, repositioning, or efficiencies) would lead to a likely price increase on the order of 5%.[108]

As a result, the Judgment may also be vulnerable in imposing a "particularly close competitors" requirement on the Commission to prove unilateral effects, including because the Court of Justice could consider that doing so could vitiate the goals of amending the EUMR to close the "gap" between cases that created a dominant position and the larger universe of those that lead to harm.

Irrespective of whether the Court of Justice affirms the Judgment's finding in this respect, we would expect the Commission to consider carefully the types of evidence that it must bring to bear in future unilateral effects cases. The Judgment may temper the Commission's reliance on qualitative evidence such as internal documents and surveys, unless it can demonstrate that the merging parties' internal documents focus predominantly on one another—and thus indicate that the parties are particularly close competitors. Outside of those cases, quantitative methods are likely to become more important, as they permit the Commission to "demonstrate" that a transaction is likely to lead to competitive harm. For such quantitative analyses to be credible and meaningful, however, the Commission will need to more seriously assess the effect of remedies, entry, repositioning, and efficiencies on the model.

c. The role of efficiencies

The Court was concerned by the way the Commission's merger simulation was structured, as it would always predict a price increase for any horizontal merger, no matter how small—a fact acknowledged by the Commission.[109] The Commission's summary dismissal of discrepancies in the predicted price effects in this case, as compared to only slightly lower predicted effects in the cleared Irish case and higher predicted effects in the German case, by saying in its Decision that merger simulation results are "*only one of the elements at the basis of the Commission assessment*" was not reassuring.[110]

The Commission was of course correct to note that it is not *bound* by its factual assessments in previous cases, as established in, for example, *General Electric*.[111] But there is a distinction between being bound in the sense of being unable to reach a different conclusion and simply being bound to explain reasoning in a way that reassures the Courts and community that the Commission is deciding cases based on the reasons that it gives in its decisions. The EU courts have never absolved the Commission from the latter obligation, and to do so would contravene the principle of the fair administration of justice.

Viewed in that light, the Judgment's insistence that the Commission make some provision for the "*standard efficiencies*" in ordinary transactions and—more generally, to take efficiencies more seriously—appears reasonable. We would expect this aspect of the Judgment to be upheld on appeal, requiring the Commission to incorporate efficiencies into its quantitative modelling—and pushing the Commission to develop an objective basis for determining when the results of its quantitative models establish anti-competitive effects, and when they do not. More generally, we hope the Court of Justice will oblige the Commission to more openly explain what role quantitative models play in its

[108] Assuming equal prices from each merging party and linear demand.

[109] Judgment ¶ 263.

[110] Commission Decision ¶ 3059.

[111] Case T-210/01 General Electric v. Commission, ¶¶ 118, 120.

analysis and to adjust them based on all the evidence in the case.

However, standard efficiencies aside, the Court did not discuss, let alone criticise, the Decision's rejection of the detailed efficiencies analysis Three had actually submitted. For example, Three submitted a detailed quantification of the efficiencies using an engineering model that it uses to plan its capacity in the ordinary course.[112] The Commission argued that the model overstated the likely marginal costs of expanding capacity that the parties would face without the transaction.[113] Its specific criticisms were redacted, but appear to relate primarily to a concern that the parties overstated likely future consumer demand for data and to disagreements regarding the types of network infrastructure the parties could deploy to create more capacity.[114] In particular in attacking merger specificity, the Commission noted that the UK government had committed to release 190 MHz of spectrum for auction in 2016, with deployment possible starting in 2022—*seven years* after the merger.[115] The Commission also raised doubts over whether consumers would value the increased speeds the network could provide, essentially assuming that consumers value speed at zero above a relatively low threshold for video quality.[116] The Commission had refused to make any corrections based on the issues it asserted, complaining that it lacked certain data to do so.[117]

The Court thus missed an opportunity to provide guidance on this important area. As Three's experience demonstrates, the Commission's approach to efficiencies arguments put forward by the merging parties has been particularly harsh relative to how the Commission addresses other arguments. In particular, the Commission has often relied on purely qualitative evidence to establish anticompetitive effects, or quantitative evidence showing the predicted price increase was limited, while rejecting the reliability of the merging parties' quantitative evidence on efficiencies.

Notwithstanding the above, we think it unlikely that the Court of Justice will reverse the burden of proving efficiencies to the Commission. As the Commission notes, "*most of the information [to prove efficiencies] is solely in the possession of the merging parties*", and that is a justification for placing the burden on the merging parties to bring forward evidence of efficiencies.[118] But the same rationale should not justify the Commission's insistence that, unless the parties' proffered efficiencies meet what to date has been a never-fulfilled evidentiary bar, the Commission is entitled to dismiss all evidence in this respect.

Interestingly, the Commission blurred the line between competitive effects and efficiencies in similar circumstances in its *Tele2* decision, which post-dated the *Three/O2* case. There, the Commission did endorse as part of its assessment of competitive effects that, absent the merger, Tele2 was likely to face capacity constraints that would raise its costs and, therefore, its prices.[119] The Commission also appeared to accept that the combined firm would avoid these pressures and that this might stimulate competition.[120] Rather than identify and endorse these effects—lower costs with the merger than without—as efficiencies, the Commission instead characterized the predicted price increase from the merger in light of this future deterioration.[121]

Thus, in some ways, the Commission has put itself in this situation by setting an unrealistically high bar for efficiencies, even when they clearly played some role in the Commission's real decision process in past cases.

112 Commission Decision ¶ 2422.
113 Commission Decision ¶ 2423.
114 Commission Decision ¶ 2521 et seq.
115 Commission Decision ¶¶ 133–34.
116 Commission Decision ¶ 2461 ("The Commission therefore considers that the increase in average speeds in cases where the speed would be above the minimum threshold has likely limited impact.").
117 Commission Decision ¶ 2455 n. 2159.
118 Commission Decision ¶ 2346.
119 Case COMP M.8792 – *T-Mobile NL/Tele2 NL* ¶¶ 524, 544.
120 *Ibid.* ¶¶ 784–85.
121 *Ibid.* ¶ 823.

V. Implications for merger control

The most important implication of the Judgment is likely to be the tightening of substantive assessment for mergers in oligopolistic markets, where the Court appears to have raised the bar for Commission intervention.

In recent years, the Commission has often approached cases of this nature by constructing a large body of evidence that points to the significance of the target's role on the market. However, the Commission has not always drawn those strands into a compelling and holistic explanation of *how* the concentration at issue will *significantly* affect competition. That may now be more difficult, as the Judgment requires the Commission to show that a concentration will eliminate important competitive constraints that the merging parties had exerted on each other (and reduce competitive pressure on the remaining competitors). The mere reduction in the number of competitors—even in an oligopolistic market—is, in itself, insufficient.

At the very least, this will require the Commission to explain more clearly how the evidence it compiles demonstrates that a concentration can be expected to significantly impede competition. It may even result in less intervention in transactions in oligopolistic markets, especially "four-to-three" deals that had been subject to increasing intervention in recent years. Furthermore, the Commission will have to consider remedy proposals offered by the merging parties in a more detailed way, in particular where they strike the right balance between preserving the dynamic efficiencies related to investments in network and quality on the one hand and ensuring a healthy degree of price competition on the other.

Although this is more likely to result in clearance decisions, another likely consequence of the Judgment will be that complex merger control review processes may become even more demanding, as Commission case teams work harder to insulate future decisions from judicial review. In particular, in the past the Commission has been content to dismiss party arguments regarding remedies, entry, repositioning, and efficiencies as lacking sufficient evidence, without going beyond those analyses to establish its own point of view of the impact of those factors on its competitive assessment. Following the Judgment, the Commission staff may insist on sufficient information to take such a position.

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