SULLIVAN & CROMWELL LLP

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EU Merger Control

European Commission's Broad-Brush "Four-To-Three Is Bad" Approach Taken Down By General Court In Three-O2 Judgment

SUMMARY

On 28 May 2020, the General Court of the European Union ("**General Court**") handed down its judgment in Case 399/16 *CK Telecoms UK Investments Ltd v European Commission* (the "**Judgment**"), annulling the decision of the European Commission ("**Commission**") of 11 May 2016, which prohibited the merger of the two mobile network operators O2 and Hutchison 3G UK ("**Three**").

The Judgment represents a significant blow to the European Commission's established merger policy in the telecommunications sector and possibly beyond. Challenging four-to-three consolidation in the telecommunications sector as a matter of routine has been a central and heavily criticised feature of the Commission's merger policy under Commissioner Vestager's watch.

In the General Court's view, by merely counting down the number of players and assuming rather than showing negative effects from such consolidation, the Commission committed "*several errors of law*". The Judgment will thus rekindle interest in telecoms consolidation across Europe. Its broader implications for the EU's merger policy beyond the telecommunications sector remain to be seen.

However, of general interest is the General Court holding the Commission accountable for inconsistencies with past (non-challenged) merger decisions and its emphasis on the (higher) burden of proof, which the Commission must discharge in order to show so-called non-coordinated effects as a result of which a merger in a non-collusive oligopoly context should be blocked. In the meantime, the Commission can be expected to appeal the decision to the EU's highest court.

BACKGROUND

Having concluded that it was better placed to ensure consistency in the application of EU merger control rules in the mobile telecommunications sector,[1] the Commission decided on 4 December 2015 not to refer the review of the Three/O2 merger to the UK Competition and Markets Authority ("**CMA**"). Following its in-depth investigation, the Commission prohibited the merger on 11 May 2016 on the basis that it would lead to anticompetitive effects in the retail and wholesale mobile telecommunications markets in the UK. The Commission found that the merger would lead to less choice and higher prices for UK mobile customers, and less innovation in the mobile sector. It made these findings primarily on the basis that the market is highly concentrated, with the merger leading to a reduction from four to three main operators.

On 25 July 2016, CK Hutchison, which owns Three, brought an action for annulment of the Commission's decision before the General Court.[2] It argued that the Commission had overstepped its assessment powers under the EU Merger Regulation by failing to properly analyse the competitive effects of the merger in the UK market. CK Hutchison criticised, *inter alia*, (i) the Commission's finding that the merger would eliminate Three as an "important competitive force" from the retail and wholesale mobile telecommunications markets; (ii) the Commission's analysis of the price effects following the merger; and (iii) the weight attributed by the Commission to the effects of the merger on other competitors with whom O2 and Three had network-sharing agreements (Vodafone and EE/BT respectively), seemingly basing its theory of harm on the protection of competitors rather than competition. The UK, which (through the CMA and Ofcom) had been cooperating closely with the Commission in its review of the merger and which had strongly advocated in favour of blocking the merger,[3] intervened in the proceedings in support of the Commission.

On 28 May 2020, the General Court ruled in favour of CK Hutchison and annulled the Commission's decision of 11 May 2016. The Judgment is the first time the EU judicature has expressly interpreted the EU Merger Regulation with regard to the compatibility of a merger giving rise to non-coordinated anticompetitive effects in an oligopolistic market, *i.e.*, a market characterised by the presence of only a few players, none of which is significantly stronger than another, and which closely follow each other's market conduct without having to engage in (unlawful) collusive behaviour.

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1 Amongst others, the Commission referred to its reviews of transactions in the mobile telecommunications sector in Denmark (the abandoned merger of Telenor and TeliaSonera in 2015), Germany (acquisition of E-Plus by Telefónica Deutschland in 2014), and Ireland (acquisition of Telefónica Ireland by Hutchison 3G in 2014).

2 The UK mobile network operator Three is owned by CK Telecoms UK Investments Ltd, a subsidiary of CK Hutchison and the applicant in the case. O2 is owned by Telefónica.

3 Ofcom comment on the proposed merger of Three and O2 (1 February 2016), available at https://www.ofcom.org.uk/about-ofcom/latest/media/speeches/2016/three-and-o2-merger.

KEY TAKEAWAYS

A. THE COMMISSION'S BURDEN OF PROOF

As a general matter, the General Court recalled that it is on the Commission to show that a merger would significantly impede effective competition.[4] The General Court emphasised that this threshold is not easily met, especially where the analysis is inherently complex or uncertain (as is the case of a merger in an oligopolistic market such as the mobile telecommunications market). Being forward-looking in nature, the competitive analysis "*must be carried out with great care*"[5] because it is fundamentally a prediction of the likely future economic effects of a merger and not, as such, based on hard evidence. The General Court stressed that the Commission's theories of harm must be sufficiently realistic and plausible. The Commission must show a "*strong probability*"[6] of significant competitive harm following the merger – merely showing that an SIEC would be "*more likely than not*" on the basis of a balance of probabilities (as the Commission argued) would not meet the evidentiary threshold as required under the EU Merger Regulation when assessing an oligopolistic merger. Although the General Court stated that the Commission is under no obligation to show that the merger would lead to anticompetitive effects beyond all reasonable doubt,[7] the burden of proof thus appears to be more demanding of the Commission in a case where it considers the effects of a non-collusive oligopoly in a concentrated market. Although the General Court insists that the *standard* of the burden of proof is the same as in any other merger case,[8] the Judgment implies that the demands as to the *quality of evidence* produced by the Commission to establish that it is necessary to prohibit the merger are inevitably higher.[9] Because the anticompetitive effects of mergers in such markets would only manifest themselves in the medium- to long-term,[10] the nature of the analysis is all the more complex and uncertain, which in turn places a more onerous obligation on the Commission in discharging its burden of proof.

On the facts, the General Court held that the Commission's "*cursory references*"[11] to general evidence were insufficient to demonstrate that the merger would lead to anticompetitive effects in the UK. The Commission was under an obligation to identify *specifically* the nature of the alleged anticompetitive effects and whether they would lead to a *significant* impediment to effective competition.[12] For example, the General Court held that the Commission's upward pricing pressure analysis (which predicted that

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4 Paragraphs 110-118 of the Judgment.

5 Paragraph 112 of the Judgment.

6 Paragraph 118 of the Judgment.

7 Paragraph 118 of the Judgment.

8 Paragraph 109 of the Judgment.

9 Paragraph 111 of the Judgment.

10 Paragraphs 276 and 415 of the Judgment.

11 Paragraph 288 of the Judgment.

12 Paragraphs 288-290 of the Judgment.

the merger would "probably" result in price increases), was insufficient to determine decisively that the merger would result – with strong probability – in *significant* price increases (and thus in an SIEC).[13]

As part of this assessment, the General Court also considered the (in)consistency of the Commission's past decisional practice in the telecommunications sector, though not legally binding on the Court, noting that a predicted price increase of 6.6% and 9.5% in previous merger cases had not prevented the Commission from authorising those transactions in the past.[14] It is highly unusual for the Commission to have to defend its merger analysis in light of its past decisions before the Court – especially bearing in mind the Commission's political constitution.[15] The Judgment thus illustrates the scrutiny with which the Court will examine a Commission's decision to prohibit a merger in an oligopolistic market (even when it leads to a reduction of players from four to three), and that it may hold the Commission to account in terms of the coherency of its own decisions – present and past.

B. THE IMPORTANCE OF "COMPETITIVE FORCE" AND "COMPETITIVE CONSTRAINTS"

Before the coming into force of the current EU Merger Regulation on 1 May 2004, there was a perceived gap under the prior Regulation, which required prohibition only when a merger would create or strengthen a dominant position, as a result of which effective competition would be significantly impeded. However, given that tacit collusion in oligopolistic markets (*i.e.*, markets with no dominant undertakings) is similarly prone to produce anticompetitive effects,[16] the EU Merger Regulation was overhauled in 2004, and now contains the test of whether a merger will result in a significant impediment to effective competition, extending the old dominance test to cover *any* significant impediment to effective competition (whether caused by dominance or not),[17] and thus closing the "oligopoly gap".[18] According to recital 25 of the EU Merger Regulation, the elimination of "*important competitive constraints*" that the merging parties had previously exerted on each other, and other competitors, may

[13] Paragraphs 268 and 282 of the Judgment.

[14] Paragraph 273 of the Judgment.

[15] The previous transactions referred to by the General Court were cleared under Joaquín Almunia as Commissioner for Competition, who was succeeded by Margarethe Vestager on 1 November 2014.

[16] EU law makes a distinction between (illegal) tacit collusion and (legitimate) parallel behaviour, which allows players in a concentrated market to adapt intelligently to the behaviour of their competitors, see, *e.g.*, Joined cases C-89/85, C-104/85, C-114/85, C-116/85, C-117/85 and C-125/85 to C-129/85 *Ahlstrom Ahlström Osakeyhtiö v Commission (Woodpulp II)* [1993].

[17] In this way, the SIEC test is a compromise between the old dominance test and the substantial lessening of competition ("**SLC**") test adopted by the CMA.

[18] Previously, the Courts adopted the concept of "collective dominance" to close the oligopoly gap. In its *Airtours* decision of 6 June 2002 (Case T-342/99), it held that "*[a] collective dominant position significantly impeding effective competition […] may thus arise as the result of a concentration where, in view of the actual characteristics of the relevant market and of the alteration in its structure that the transaction would entail, the latter would make each member of the dominant oligopoly, as it becomes aware of common interests, consider it possible, economically rational, and hence preferable, to adopt on a lasting basis a common policy on the market with the aim of selling at above competitive prices, without having to enter into an agreement or resort to a concerted practice within the meaning of Article [101 TFEU] and without any actual or potential competitors, let alone customers or consumers, being able to react effectively.*" (paragraph 61).

result in an SIEC in oligopolistic markets. Similarly, paragraph 37 of the Commission's Merger Guidelines[19] states that a merger involving a firm with more of an influence on the competitive process than their market shares would suggest (an "*important competitive force*") may change the competitive dynamics of a concentrated market, such an oligopolistic market, in an anticompetitive way.

Although CK Hutchison did not dispute that the Three/O2 merger would have reduced the number of operators from four to three, it argued that the Commission was wrong to characterise Three as an "important competitive force". The Commission, on the other hand, maintained that Three, despite its moderate market share, was the most aggressive and innovative player, in particular because it offered 4G to its customers at no extra cost.

The General Court found that the Commission had wrongly lowered its burden of proof by asserting that the decline of competitive pressure that would result from the loss of Three as a market participant was sufficient to prove an SIEC, without adducing sufficient evidence that Three actually *stood out* amongst its competitors in any meaningful way.[20] The General Court noted that Commission's proposed approach would allow it to prohibit *any* horizontal mergers in oligopolistic markets, by simply basing its conclusion on an (undefined) reduction of competitive pressure, allowing the Commission to forego its analysis of whether the merger would lead to the elimination of an important competitive constraint within the meaning of the EU Merger Regulation.

However, the General Court's distinction between "*important competitive forc*e" (as used in paragraph 37 of the Commission's Merger Guidelines) and "*important competitive constraint*" (as used in recital 25 of the EU Merger Regulation) in this regard remains opaque and is likely to be a potential point of appeal.[21] The Judgment suggests that, while an undertaking may exert an important competitive *force* within the meaning of the Merger Guidelines (the elimination of which would cause a decline in the competitive pressure in the market), this undertaking does not by virtue of this fact alone also exert an

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19 OJ 2004 C 31.

20 The General Court found that the Commission made four manifest errors of assessment in relation to the retail market: (i) Three was not an important competitive force merely because of its share of new customers won, especially in light of other players identified by the Commission as "important competitive forces" having higher shares of new customers (paragraphs 179-189); (ii) the evolution of Three's market share and customer base growth was not sufficient to show that it was an important competitive force, especially given that Three was the smallest player in the market and experienced weaker subscriber growth in recent years (paragraphs 191-197); (iii) the Commission failed to show convincingly that Three's allegedly "*aggressive*" pricing in some (but not all) market segments and the inclusion of 4G at no extra cost did not significantly alter the competitive dynamics on the market (paragraphs 199-216); and (iv) the Commission could not rely on Three's historical "*disruptive*" behaviour when it first entered the market as it failed to show how this would be relevant to the forward-looking merger analysis (paragraphs 217-225). In relation to the wholesale market, the General Court found that the Commission had not sufficiently shown that Three (which had a less than 5% market share) was an important competitive force and that it stood out from other market participants (paragraphs 438-453).

21 The General Court even appears to use the two concepts interchangeably in places, see, *e.g.*, paragraphs 195-197 of the Judgment.

important competitive *constraint* (which would require it to "stand out" amongst its competitors according to the General Court), the elimination of which may, in turn, lead to an SIEC.[22]

C. THE PROTECTION OF COMPETITION AS UNDERLYING AIM

Finally, the Judgment reaffirms the fundamental notion that the underlying aim of EU merger control, and EU competition law generally, is to protect competition – not individual competitors.

According to the Commission, Three and O2, as partners to the two separate network-sharing agreements with EE/BT and Vodafone, respectively, had an incentive to jointly develop the network, to innovate and to compete with other mobile network operators (in particular the mobile network operators in the other network-sharing agreement). Post-merger, this competitive dynamic would be lost because the merged entity would be party to both network-sharing agreements. They would no longer be fully-committed partners.

Although the General Court accepted the Commission's (novel) "theory of alignment of interests" of partners to a network-sharing agreement, it found that the Commission had not shown that any misalignment post-merger would result in any harm to competition (other than its potential (negative) effects on EE/BT and Vodafone). Even on the assumption that Three were to terminate its agreement with EE/BT, this would not necessarily harm competition – on the contrary, it would likely encourage greater infrastructure competition.[23] The General Court restated the basic notion that harm to competitors, in the absence of any sufficiently realistic and plausible causal link showing consequent harm to competition, is not in itself sufficient to show that a merger would lead to an SIEC.[24] In line with the framework for the protection and promotion of the internal market, as set out by the Treaty on European Union and the Treaty on the Functioning of the European Union, the General Court reaffirmed that EU merger control seeks to primarily protect competition as such – for the benefit of consumers, the public interest and, ultimately, individual undertakings.

CONCLUDING REMARKS

The Judgment is a rare example of an appeal against a Commission decision made under the EU Merger Regulation, won entirely on the basis of the defects of the Commission's substantive economic analysis. The Judgment reiterates the most fundamental concepts of EU merger control and is a sign of increased judicial review by the EU judicature of the Commission's substantive merger control analysis.

The General Court's emphasis of the (heightened) burden of proof on the Commission is to be welcomed. A point which the Commission is likely to appeal in the European Court of Justice, however, is the nature and scope of this burden in oligopolistic merger cases. The General Court held that it was

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22 Paragraph 173 of the Judgment. See also paragraph 453 of the Judgment.

23 Paragraphs 345-364 of the Judgment.

24 See, *e.g.*, Paragraphs 362, 368, 372, 375-376, 379. 381, 388-389 of the Judgment.

irrelevant that Three was widely regarded as a "*maverick*" competitor, boasting exponential growth in a heavily concentrated market and offering products and services at cheaper prices (*e.g.*, 4G at no extra cost). This would not in itself constitute sufficient evidence that the merger would lead to an SIEC. The question thus remains: what does it take for a competitor to actually "*stand out*" as an "*important competitive force*", exerting "*important competitive constraints*" in an oligopolistic market?

Apart from its obvious relevance in a telecommunications market context, the General Court's endorsement of the notion that a four-to-three merger will not necessarily be prohibited is potentially relevant for mergers in other oligopolistic markets. The Judgment confirms that the Commission is under a legal obligation to carry out its merger analyses based on convincing evidence and, above all, to base its conclusions on more than mere theoretical possibility. It also illustrates the judicial scrutiny which a Commission decision based on a non-collusive, non-dominant theory of harm must be able to withstand in order to be upheld by the General Court. The Judgment serves as a timely reminder of the threshold the Commission must meet when declaring a merger incompatible with the internal market in an age in which it appears fashionable for certain European competition authorities to take an increasingly interventionist approach.

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CONTACTING SULLIVAN & CROMWELL LLP

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CONTACTS

New York

Werner F. Ahlers	+1-212-558-1623	ahlersw@sullcrom.com
Francis J. Aquila	+1-212-558-4048	aquilaf@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohena@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Scott B. Crofton	+1-212-558-4682	croftons@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
John Evangelakos	+1-212-558-4260	evangelakosj@sullcrom.com
Sergio J. Galvis	+1-212-558-4740	galviss@sullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@sullcrom.com
Matthew B. Goodman	+1-212-558-4995	goodmanm@sullcrom.com
Dustin F. Guzior	+1-212-558-4482	guziord@sullcrom.com
Brian E. Hamilton	+1-212-558-4801	hamiltonb@sullcrom.com
Steven L. Holley	+1-212-558-4737	holleys@sullcrom.com
Matthew G. Hurd	+1-212-558-3122	hurdm@sullcrom.com
Stephen M. Kotran	+1-212-558-4963	kotrans@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Keith A. Pagnani	+1-212-558-4397	pagnanik@sullcrom.com
Richard A. Pollack	+1-212-558-3497	pollackr@sullcrom.com
George J. Sampas	+1-212-558-4945	sampasg@sullcrom.com
Melissa Sawyer	+1-212-558-4243	sawyerm@sullcrom.com
Alan J. Sinsheimer	+1-212-558-3738	sinsheimera@sullcrom.com
Krishna Veeraraghavan	+1-212-558-7931	veeraraghavank@sullcrom.com
Benjamin R. Walker	+1-212-558-7393	walkerb@sullcrom.com

Washington, D.C.		
Renata B. Hesse	+1-202-956-7575	hesser@sullcrom.com
Joseph J. Matelis	+1-202-956-7610	matelisj@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Los Angeles		
Eric M. Krautheimer	+1-310-712-6678	krautheimere@sullcrom.com
Rita-Anne O'Neill	+1-310-712-6698	oneillr@sullcrom.com
Adam S. Paris	+1-310-712-6663	parisa@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com
Palo Alto		
Scott D. Miller	+1-650-461-5620	millersc@sullcrom.com
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
London		
John Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
Jeremy B. Kutner	+44-20-7959-8484	kutnerj@sullcrom.com
Ben Perry	+44-20-7959-8477	perryb@sullcrom.com
Richard A. Pollack	+44-20-7959-8404	pollackr@sullcrom.com
Juan Rodriguez	+44-20-7959-8499	rodriguezja@sullcrom.com
Paris		
Olivier de Vilmorin	+33-1-7304-5895	devilmorino@sullcrom.com
Frankfurt		
Carsten Berrar	+49-69-4272-5506	berrarc@sullcrom.com
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
York Schnorbus	+49-69-4272-5517	schnorbusy@sullcrom.com
Brussels		
Michael Rosenthal	+32-2896-8001	rosenthalm@sullcrom.com
Tokyo		
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong		
Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Kay Ian Ng	+852-2826-8601	ngki@sullcrom.com
Beijing		
Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com
Melbourne		
Waldo D. Jones, Jr.	+61-3-9635-1508	jonesw@sullcrom.com
Sydney		
Waldo D. Jones, Jr.	+61-2-8227-6702	jonesw@sullcrom.com