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Mergers and the Regulatory Environment

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Competition

Mergers and the Regulatory Environment

Good morning.

This event has become a key global forum for lawyers, academics and enforcers. Barry Hawk, and all the organizers, you deserve a lot of praise for what you have achieved. We thank you, in particular, for having facilitated contacts, exchanges and contributed to the increasing convergence of competition law and policy on both sides of the Atlantic.

I will be discussing mergers and the regulatory environment. I would like to divide my talk into two parts. First, I will look at the regulatory environment for merger control. Are our tools appropriate? Or does the EU Merger Regulation require changes to continue to effectively ensure competitive structures? In addressing these questions, I would like to convey to you some of the key messages of an important document - the White Paper "Towards more effective merger control"¹ - that was adopted by the European Commission last July.

Secondly, I will look at the interplay between sectoral regulation and merger control. In the last few years we have assessed a number of mergers in regulated industries and liberalised sectors, where this interplay played an important role in our decisions. I'd like to present some of these cases and draw a few lessons from our experience.

The regulatory environment for EU merger control

Ten years have elapsed since the last reform of the EU Merger Regulation, initiated by Commissioner Monti in 2004. It is a good moment to look back and evaluate the results of these reforms.

This we have done in some detail in the White Paper. And I'd like to make a couple of observations.

First: We now have a broadly satisfactory substantive framework for merger assessment.

In 2004, we introduced the new substantive test for mergers. In the intervening period, this been elaborated by a number of guidelines. As a

¹ COM(2014)449 final,
http://ec.europa.eu/competition/consultations/2014_merger_control/index_en.html.

result, we have shifted the focus in our assessments from the structural impact of mergers, to their likely negative impact.

The new test has removed possible gaps in the assessment of mergers in oligopolistic markets. It has also made a more economically sound analysis of vertical mergers possible. Thanks to the reforms, the analysis of efficiencies has become a common feature in any in-depth investigation.

A second observation: In the last ten years, we prohibited only six mergers.² We solved 172 mergers through conditional decisions involving remedies. This amounts to an intervention rate of around six per cent.

Between 2010 and 2013, 72 per cent of these remedies involved divestitures. This illustrates that our remedies policy, with its clear preference for structural solutions, has become firmly consolidated.

Third. Over the last ten years, this substantive framework, together with improved procedures and checks and balances, has ensured a near-100 per cent success rate before the EU Courts. No merger decision on substance taken after 1 May 2004 has been overturned by a final judgment of the EU Courts.³

Fourth: In the last ten years, convergence between merger assessment at the European and national level has increased markedly. Thanks to the 2004 reforms, referrals between these two levels have become very frequent. Coupled with increased market integration, this had made it possible for the Commission to increasingly focus its analysis on cross-border operations. (In 2013, 85 per cent of cases were cross border, up from 74 per cent in 2004).

A fifth and final observation concerns complexity. Investigations of difficult mergers have undeniably become more complex. Economic submissions and detailed analysis of internal documents play a more

² Between 2004 and August 2014. This figure includes EDP/GDP, which was prohibited in December 2004, i.e. after the re-cast Merger Regulation came into force, but still under the old Merger Regulation.

³ The only decision on the substance of a merger case adopted after 1 May 2004 overturned by the General Court was the first unconditional clearance decision in Sony/BMG. It was later, however, upheld on appeal by the Court of Justice. The only merger decision annulled by a final judgment was the first purchaser approval in Lagardère/VUP (annulled by the General Court, confirmed by the Court of Justice). Both of these decisions had been adopted under the old Merger Regulation.

important role than ten years ago. At the same time, however, we have streamlined the treatment of straightforward cases and reduced information requirements. Since the introduction of these new rules in January, we have cleared 69 per cent of cases using the simplified procedure.⁴

So, all in all, a major overhaul of the system does not seem warranted. Nevertheless, one of the positive features of EU merger control, and I would dare to say, of EU competition policy more broadly, is its ability to periodically question its rules and principles and propose ways to improve them.

This is, precisely, what the second part of the White Paper adopted in July attempts to do. It focuses on two main issues: first, to expand the scope of merger control, to deal effectively with harmful acquisitions of minority shareholdings. Second, it proposes to further streamline and reduce red tape, in particular regarding referrals.

The fact that acquiring a minority stake into a competitor, even short of control, can create anti-competitive harm is well established. But, while the US, and other jurisdictions, include these acquisitions within the scope of merger control, this is not the case in the EU.

The White Paper proposes to remedy this gap, but in a way that would not create undue or disproportionate burdens for business. In a nutshell: we do not propose to extend the notification obligation to these operations. Parties will only have to provide a limited information notice about potentially harmful operations. According to the proposal, the Commission will decide whether an in-depth investigation is required. If not, notifications will be considered approved after a short period of time.

Other proposals include simplifying the referral of cases to the Commission. For instance, cases that now require notifications to at least three Member States, could instead be directly notified to Brussels. This will eliminate red tape and substantially reduce the time needed to deal with these referrals. The Paper also proposes to eliminate the notification obligation for simpler concentrations.

This is not yet a legislative proposal. These are well thought-ought reforms, but they can still be modified. A public consultation is on-going and views and suggestions for improvement are welcomed. The Paper and the replies to the consultation will serve as a basis for reflection for

⁴ 136 out of 178 Phase I clearances.

the new Commissioner and College, who will have to decide whether and how they will move this reform forward.

Let me switch now to the second part of my talk.

Having analysed the state of the regulatory framework of EU merger control, let's see how it interplays with other frameworks, and in particular with sectorial regulation in liberalised industries. This interplay can be examined from different perspectives.

De-regulation as a source of merger activity

To start with, many studies argue that deregulation can cause merger waves, usually in combination with other technological and economic changes.⁵ Removing obstacles to operate in previously reserved sectors opens opportunities for new entry, either independently, through acquisitions or other business combinations.

We have seen a number of examples of this, most recently in the rail sector. While deregulation of national passenger services has yet to start in a number of Member States, freight and international passenger travel are now fully liberalised.

Deregulation in rail transport made mergers possible.⁶ In 2011 French rail company Veolia and Italian incumbent Trenitalia formed a Joint Venture to offer international train services between France and Italy. Before liberalisation, Veolia didn't operate rail services in France. SNCF was the only company allowed to do it. The joint venture was created to exploit new competition possibilities, and was logically quickly authorized.

Liberalisation also presented opportunities under the British Channel. Deregulation enabled other companies besides Eurostar – such as Deutsche Bahn – to offer services between London and Paris. The Eurostar partners, SNCF and London Continental Railways, decided to replace their loose cooperation of the past with a fully integrated Joint Venture.

This was also approved, but, in this case, subject to commitments that would remove barriers to entry for newcomers. For instance, access to facilities such as maintenance shops and ticket offices.

⁵ For instance: Patrick A. Gaughan, *Mergers, Acquisitions, and Corporate Restructurings* [Fourth Edition] (New Jersey, 2007), 29.

⁶ http://europa.eu/rapid/press-release_IP-11-917_en.htm

Consolidation in the sector continues. We are now assessing a Joint Venture between SNCF and SNCB, the French and Belgian incumbents, aimed at improving services on their Thalys network.

Sectoral regulation as a factor in merger assessment

These examples already show that, when it comes to liberalisation and competition, we can observe a paradox. Liberalisation does not necessarily mean that market forces can operate freely; to guarantee competition in a liberalised market, you often need some degree of public intervention and regulation. And this type of regulation can have an important impact on the assessment of mergers in these sectors

First, regulation has an impact on the definition of the relevant markets. In recent months we've dealt with a number of mergers in the telecoms sectors. The large multinationals involved are repeatedly asking us to stop concentrating on national markets. Instead, because they operate globally, they want us to look at the global picture.

However, we cannot choose market definitions as we please, any more than we can change the weather in Brussels.

Market definitions are not policy statements. They are investigations into facts. We make a comprehensive and accurate analysis of competitive constraints. In other words, we define product or geographic markets based on market realities.

Recently, we have thoroughly examined our past merger data, looking at several long term trends. With regards to geographic market definition it is interesting to note that, in contrast to some perceptions, the Commission is not overly focused on national markets. In the most recent period examined (2012-2013), national markets were found in only 30 per cent of cases.

But in retail telecoms, and in particular in mobile telephony, we always found national markets.

To illustrate this point, let me use the famous quote by Henry Kissinger, who once said he didn't know who to call if he needed to phone Europe.

Nowadays the reply is simple, he should call the EU High Representative for Foreign Affairs; but he may still have trouble finding the phone number – is he going to call Ms Mogherini on her Belgian, or Italian mobile?

There are no pan-European operators. As a customer, I cannot get a European mobile subscription with an EU dial-in code.

This has to do again with waves. Not merger waves, but radio waves.

National telecom regulators define frequencies and allocate spectrum. The scope of these spectrum allocations outlines the area in which operators compete. And this is what defines the relevant geographic market.

Every time users cross a border, their devices switch to a new network operator. Users need a new contract when taking up residence in another Member State to avoid roaming fees. For these reasons, mobile network operators still compete on a national basis, even if they are owned by larger, sometimes pan-European or even global operators.

Of course, as in other industries, there are also other aspects besides regulation that can establish a national market definition, such as brand names and consumer preferences. For instance, we can observe quite different patterns of pre-paid or post-paid mobile phone contracts in various Member States. Likewise, in some countries customers use cell phones for data access to a much larger extent than in others, which affects the way mobile operators compete in the market.

EU Commission President-elect Juncker has called for the creation of a digital single market, by breaking down national barriers in telecoms regulation, copyright and data protection and in the management of radio waves.⁷ This is likely to be one of the priorities of the new College of Commissioners and it could have, in the future, an impact on how markets are defined.

In fact, we have already seen instances where liberalisation has led to changes in market definition.

The Third Internal Energy Market Package adopted in 2009 aimed to create a single EU market for electricity and gas through linking together the energy grids across Europe.

⁷ Full quote: "I believe that we must make much better use of the great opportunities offered by digital technologies, which know no borders. To do so, we will need to have the courage to break down national silos in telecoms regulation, in copyright and data protection legislation, in the management of radio waves and in the application of competition law."

In the past, we considered the upstream supply of gas a national market. But this has changed. In a recent decision on Gazprom's acquisition of German gas supplier Wingas⁸ we argued that increased interconnector capacity could possibly create markets encompassing several North West European Member States.

More generally, we see that the way that we define geographic markets evolves with time.

In our decisions, we have increasingly defined EEA or wider geographic markets, from 48 per cent in 2004 to 61 per cent in 2013. EU market integration, among other factors, has probably contributed to this change.

To conclude on this point, geographic markets are defined on the basis of business and regulatory realities, but when the latter change, competition authorities take them into account. Market definitions do not have an immutable nature.

Competitive assessment and remedies

Besides influencing market definition, the regulatory environment also has an important impact on how we assess and remedy the anti-competitive effects of mergers. I've already mentioned that we have recently examined a number of mergers in the telecoms sector. In particular, we assessed three mobile telephony deals, in Austria, Ireland and Germany.

All of these were four-to-three mergers. Because a competitor vanishes from a concentrated market, this type of merger always requires attention.

This is perhaps even more so in telecoms, because new entry is particularly difficult. A new operator has to acquire spectrum, and must comply with all regulatory requirements for setting up a network. It needs to set up the network, including backbone and IT environment. It has to establish marketing, sales, customer service and support structures, and invest heavily in customer acquisition. It also has to negotiate national and international roaming agreements.⁹ If a merger in this environment has anti-competitive effects, these can be long lasting.

⁸http://ec.europa.eu/competition/mergers/cases/decisions/m6910_20131203_20310_3618213_EN.pdf

⁹http://ec.europa.eu/competition/mergers/cases/decisions/m6497_20121212_20600_3210969_EN.pdf, 70.

However, it is not possible to generalise across markets. Each country has different regulatory conditions and, as a consequence, different competitive landscapes. These specificities have to be taken particularly into account when assessing these mergers and devising appropriate remedies.

Let me describe one of these mergers, the Irish one, to illustrate this point.

In Ireland, the Commission examined the purchase of Telefonica Ireland (O2) by Hutchison 3G ("Three").

The relevant market was defined as national. Licenses to mobile network operators are limited to the territory of Ireland and coverage of mobile networks corresponds to national borders.

The operation was a 4 to 3 merger in a relatively small national market with high barriers to entry. The merger would have removed an important player - in this case H3 - leaving only two other MNOs as competitors in the market – Vodafone and Eircom.

However, in addition to the three MNOs, four MVNOs were active on the Irish market. MVNOs compete by buying airtime from MNOs and reselling it to end customers. They are subject to fewer regulatory obligations and therefore can enter the market with lower investment costs.

It is also worth noting that in Ireland, network sharing was especially important. A lot of people live in rural areas, where it is difficult to roll out mobile networks. Mobile businesses in Ireland share networks to cut costs, which has been accepted by competition and regulatory authorities.

Only Vodafone and O2 had full, national coverage. Three shared its network with Vodafone, and Eircom with O2.

The proposed merger endangered these sharing agreements. The agreement between Eircom and O2 would probably have ended completely, limiting Eircom's ability to compete. It would become more difficult for MVNOs to find a host.

In view of all of this, we concluded that the operation could have negatively affected competition in the Irish mobile telephony market.

To compensate for the disappearance of O2 from the market, Hutchison committed to continue network sharing arrangements and to sell up to 30

per cent of its network capacity to two Mobile Virtual Network Operators: UPC and Carphone Warehouse.

But we introduced some important novelties into this remedy. First, all the capacity had to be divested before the merger was implemented.

Second, in previous cases where similar remedies had been proposed (e.g. Austria) the merging parties only committed to sell capacity to MVNOs when they needed it, on a "pay as you go" basis. In Ireland by contrast, the MVNOs will pay for a fixed amount of capacity at a fixed rate. In order to recover cost, they will therefore have an incentive to attract as many customers as possible, by presenting them attractive offers. This upfront sale of capacity makes the impact of the remedy very similar to a structural divestiture.¹⁰

All this shows that merger control decisions should take utmost attention to the existing regulatory framework. This will be essential in establishing the effects of the merger and imposing, when necessary, the best way to remedy it. No generalizations are possible to this regard and future cases will have to be assessed on a case by case basis.

Conclusion

Let me conclude now.

According to academics, there have been six major merger waves. This started with the first great wave of horizontal mergers in the 1890s, ending in 2007, when the financial crisis brought an end to the sixth merger wave.

People are waiting for the seventh wave to break.

It may have started already, M&A activity is reaching very high levels this year and, in the EU, the number of deals notified at the end of August well exceeds the cases notified in the same period last year.

We are ready to deal with this new wave.

The experience of the last ten years shows that our regulatory framework is sound and efficient. We have a clear map of how we could improve it even further.

¹⁰ A similar remedy has also been imposed in the merger between Telefonica Deutschland and E-plus, that was cleared in July.

We can't change market definitions. But we can change markets.

We can build an internal telecoms market, and an internal energy market. These will be priorities for the next Commission. And this may eventually open the doors to increased consolidation in these sectors.

In the meantime, we will rely on the experience accumulated in recent times to assess new cases, taking into account specific regulatory features in our merger assessments. We will remain careful to ensure that mergers do not wipe out the benefits of liberalisation for customers and that regulation and merger control continue to work on the same direction: towards open and competitive markets.

Thank you very much.