CLi Volume 10, inBrief 8 6 September 2011

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AT&T/T-Mobile deal looks doomed

On 31 August, the US Department of Justice filed an antitrust lawsuit to stop AT&T from acquiring T-Mobile USA from Deutsche Telekom. The terms of its complaint are so stark that it is hard to envisage any divestment that might make the deal acceptable. However, early signals suggest that AT&T will not go down without a fight.

Four companies have nationwide networks and offer a homogeneous service across the whole country. They are, in order of size, Verizon (with about 34%), AT&T (31%), Sprint (17%) and T-Mobile (11%). The rest consists of about 180 smaller companies. Most are local or regional and all depend on roaming to provide an out-of-area service.

The DoJ therefore finds that the market consists of the nationwide services offered by the four companies. The network run by T-Mobile is the largest in terms of base stations, beating even Verizon, and its customer service is the highest rated (AT&T has promised repatriation of its call centre from India if the deal goes ahead).

Business and government users are treated as critical by the DoJ because the need for nationwide coverage is most acute for them. Moreover, this market segment normally buys in bulk through competitive tendering. If one keen bidder were removed, the other three might adopt a more relaxed attitude to price.

AT&T and T-Mobile compete head to head in 97 of the 100 cellular market areas that account for half the US population. A preliminary assessment puts the post-merger Herfindahl-Hirschman Index at 3,100 overall and 3,400 in the business/government segment. Both readings are well above the level where enhancement of market power is presumed.

AT&T may hope that its efficiency claims for enhanced spectrum use will win the case. The complaint dismisses them in one sentence, although the DoJ says that it gave them serious consideration. It found that the same benefits would result if the company spent the money on enhancing its own network, without eliminating a competitor.

T-Mobile has been a classic maverick competitor. It described itself as "agile and scrappy", with a will to "break down industry barriers with innovations". However, momentum has been lost and the number of T-Mobile subscribers shrank last year. The company hatched new plans to deploy "disruptive pricing" and to make smartphones affordable for the average consumer. These policies, if still current, are unlikely to survive its acquisition.

Agreeing to be acquired suggests that T-Mobile has lost confidence in its US operation. Without the deal, exit will be costly despite the $3bn break fee payable by AT&T. A merger with Sprint, as mooted before AT&T's offer was agreed, might gain antitrust clearance but would involve expensive network alignment. Private equity is currently short of the billions needed for a buyout, and T-Mobile's experience may discourage other non-US buyers. Taking the company public would be unlikely to yield anything near AT&T's $39bn. An informal solution might be for Apple to give it access to the iPhone – the lack of iPhone compatibility seems to have been a major cause of lost custom for T-Mobile.

To European eyes, an obvious remedial measure would be some form of legal control of the price of access to wireless telecoms. The market is expanding rapidly and, if roaming cost less, smaller competitors could grow. This cannot happen while the four incumbents are free to exert margin squeeze. But such a policy cannot even be contemplated in the US now, probably never.

Curiously, the complaint does not mention GSM technology – an essential if someone with a US mobile device wishes to use it when in Europe. Of the four, only AT&T and T-Mobile operate

GSM. The acquisition would take that HHI measurement from 5,000 to 10,000.

Celia Hampton

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NEWS

Consultation on Sky's movies

The UK's Competition Commission has made a provisional finding which will lead to a consultation on Sky's control over pay-TV movie rights in the UK.

The provisional finding is the result of an investigation into the supply and acquisition of subscription pay-TV movie rights following a reference in August 2010 from the national communications regulator Ofcom.

The Commission has provisionally found that Sky's position in the market is restricting competition between pay-TV providers and that this is leading to higher prices, reduced choice and less innovation.

Sky holds exclusive rights to the movies of all six major Hollywood studios in the first subscription pay-TV window (FSPTW). Because Sky has a huge number of subscribers – twice as many subscribers to pay-TV as all the other pay-TV retailers put together – none of its rivals are in a position to mount successful bids in competition.

This stalemate has held for many years. Laura Carstensen, who is chairing the Commission's investigation, says: "Recent movie content is important to many pay-TV subscribers. As a result, Sky's control of this content enables it to attract more pay-TV subscribers than its rivals. Having more subscribers increases further its advantages when bidding in the next round for pay-TV movie rights, and so it goes on."

Although Sky supplies its movie channels (Sky Movies) to some other pay-TV retailers, this supply does not, according to the Commission, enable these retailers to compete effectively with Sky for movie channel subscribers.

The Commission's provisional report says that Sky's control over recently released movies has a major effect on the pay-TV market as a whole.

In a notice of possible remedies, the Commission has put forward some specific suggestions as to what should be done. The proposals are:

- to restrict the number of major studios from which Sky may license exclusive FSPTW rights;
- to restrict the nature of the exclusive FSPTW rights which Sky can license from the major studios (for example, so that rights for distribution methods such as subscription video on demand could be made available to other providers); and/or
- to bring in "must retail" measures, which would make Sky acquire on a wholesale basis and offer to its subscribers any movie channel containing FSPTW movie content created by a rival.

New technology is bringing in significant changes to the way in which people watch TV and it may be that some of these developments will affect the market in future. For example, some firms are now offering customers the chance to see movies distributed via the internet. But the Commission feels that these innovations cannot be relied on to make the necessary adjustments in favour of a more competitive market. "We have found no evidence to date," says Laura Carstensen, "that any of these alternative providers of movie products are likely to affect significantly Sky's ability to secure the first pay-window rights of the major studios in the foreseeable future."

Responses to the notice of possible remedies should be returned by 9 September 2011. Comments on the provisional findings should be submitted by 16 September 2011. The Commission will publish its final report next year.

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NEWS

Investigating Deutsche Börse / NYSE Euronext

The European Commission has launched an in-depth investigation into the planned merger between Deutsche Börse AG and NYSE Euronext Inc, both of which operate worldwide.

Deutsche Börse is active right across the whole chain of trading, clearing and settlement of financial instruments. It operates several stock exchanges, including the Frankfurt Stock Exchange and the Eurex derivatives exchange. NYSE Euronext is also active globally. It operates a number of stock exchanges in Europe, the New York Stock Exchange and the Liffe derivatives exchange, based in London.

The Commission's initial market investigation revealed competition concerns in several areas, especially in the field of derivatives trading and clearing. Apart from anything else, the deal brings together the two largest derivatives exchanges in Europe. The Commission now has until 13 December to take a final decision on whether the transaction would reduce effective competition in the European Economic Area.

Competition Commissioner Joaquin Almunia summed up the Commission's fears by saying that "the proposed merger would remove a strong competitor from the market and give the merged company by far the leading position in derivatives trading in Europe".

At this stage, the Commission is mainly concerned that, through the removal of an important competitor, the merger would have a negative impact on innovation in derivatives products and technology solutions. In addition, the possibilities for fee competition could be reduced because it would be harder for competitors to enter the market. Affected customers could include pension funds, mutual funds and retail banks, together with professional brokers and investment banks. Following the initial investigation, the Commission has been concerned that, without access to the merged company's enlarged post-trade clearing facilities, entry by rival derivatives platforms will be trickier in a market that already has high barriers to entry.

The investigation also raised serious concerns in other areas, including equities trading and settlement and index licensing.

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Settlement in GE / Converteam acquisition

The US Department of Justice has proposed a settlement which will allow General Electric to acquire the Converteam Group, on condition that Converteam's subsidiary, the Electric Holding Group, is sold off.

The Electric Holding Group manufactures low-speed synchronous electric motors (LSSMs), which are used to drive machinery vital in the oil and gas industry. The LSSMs are made in the company's factory in Minneapolis.

Since 2007, General Electric and Converteam have competed against each other to win contracts to supply LSSMs to oil refinery customers in North America. If the acquisition had gone ahead without the sale of Electric Holding, the number of bidders on some contracts would have been reduced from three to two – and, in some cases, from two to one.

"The divestiture will preserve the benefits of competition for refinery customers in the United States," said Sharis A Pozen, acting assistant attorney general in charge of the DoJ's antitrust division. "As originally proposed, the acquisition would have lessened the competition that currently exists among manufacturers of low-speed synchronous electric motors."

GE's worldwide revenues in 2010 were $150bn. The Converteam Group SAS, which has its headquarters in France, has factories in France, the United Kingdom and the United States. In 2010, its worldwide revenues were $1.5bn and revenues from its Minneapolis factory were $47.7m.

The Department of Justice's proposed settlement is subject to the approval of the district court in Washington DC.

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NEWS

First phase of NZ air cargo case

The New Zealand Commerce Commission has been successful in the first stage of its High Court action against a group of international airlines.

In 2008, the Commission began an action against 13 airlines, alleging that they had formed a cartel and fixed prices for cargoes. The alleged price-fixing involved an agreement to impose fuel surcharges when carrying cargo in and out of New Zealand.

British Airways and Cargolux International Airlines admitted their part in the cartel and paid penalties earlier this year. Charges were dropped against two further airlines before court proceedings began against the remaining defendants, a group which includes Air New Zealand, Cathay Pacific and Emirates.

The defending airlines raised a preliminary point with the High Court, arguing that the court had no jurisdiction to deal with allegations relating to cargo which was being flown into New Zealand because the alleged competition between airlines occurred outside New Zealand's borders. According to the defendants, it followed that there was no "market in New Zealand" for these services and that the claims made by the Commission were outside the reach of the New Zealand Commerce Act.

Jurisdiction as to outgoing cargo was not disputed.

The Auckland High Court has decided against the defendants on the preliminary point, ruling that inbound air cargo services are supplied in a market in New Zealand, and that the court had jurisdiction to hear the Commission's case in full.

The arrival and handling of cargo in New Zealand, and the demand for cargo shipments from national importers, were key factors in the court's finding that a market for inbound cargo services exists in New Zealand.

The court held that it was sufficient that part of the market is situated in New Zealand, saying "the fact that part of the service takes place in New Zealand [is] an important facet of the reality that part of the market is in New Zealand".

The court rejected the airlines' argument that competition between the airlines stopped at the moment the cargo contracts were entered into at ports of origin, ruling that such a narrow analysis "does not seem in accord with the facts and common sense".

The trial continues.

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OPINION

Lessons from the Ryanair / Aer Lingus decision

While clarifying the interaction between the UK merger control regime and its EU counterpart, the case has serious implications for acquisitive companies.

*by Helen Bignall, Falk Schoening and Alice Wallace-Wright**

On 28 July this year, the UK Competition Appeal Tribunal handed down its judgment in the Ryanair/Aer Lingus case. It decided that the UK Office of Fair Trading was not out of time to investigate and refer Ryanair's minority stake in Aer Lingus to the Competition Commission for detailed review, should it decide to do so.

This case has ignited an interesting debate because the result of the CAT's judgment is that the OFT can (and will) investigate Ryanair's minority stake in Aer Lingus three years after the European Commission's decision to block Ryanair's acquisition of Aer Lingus's entire share capital, and four years after Ryanair started to acquire shares in Aer Lingus. At the same time, commentators have questioned whether the circumstances in this case are likely to be repeated. Indeed, the CAT stated that the facts were unusual and questioned how often they would recur in the UK. It added that the time bar problem which gave rise to the CAT hearing was bound up in UK legislation and unlikely to arise in the same form elsewhere in the EU.

While the facts are unusual, there are important lessons which businesses can draw from this case and potentially serious implications for companies acquiring shares in certain contexts.

Legal framework

In order for a merger or an acquisition to be reviewable by the Commission under the EU Merger Regulation (the EUMR), the transaction must constitute a “concentration”. A transaction qualifies as a concentration when there is a lasting change in the nature of control of an entity. Control is determined according to the “decisive influence” test. An entity exerts decisive influence over another when it controls its day-to-day commercial decision-making.

The EU one-stop shop principle means that member states cannot review and apply their own rules to a merger once the Commission has claimed or accepted jurisdiction.

There is no harmonisation of member states’ merger rules with the EUMR. Consequently, member states have different tests to determine control. The lowest control threshold in the UK is whether one entity has “material influence” over another – a lower threshold than the “decisive influence” required for EUMR purposes.

Background facts

100% shareholding

On 23 October 2006, Ryanair launched a public bid for the entire share capital of Aer Lingus and notified the proposed acquisition to the Commission under the EUMR. Following a detailed investigation, the Commission announced its decision on 27 June 2007 to block the merger. Ryanair unsuccessfully appealed the Commission’s decision to the General Court, which gave judgment on 6 July 2010.

Minority shareholding

In the meantime, between September 2006 and August 2007, Ryanair had gradually increased its shareholding in Aer Lingus to 29%.

In July – and again in August 2007 – Aer Lingus made a submission to the Commission arguing that it should require Ryanair to divest its minority stake. The Commission concluded that it did not have jurisdiction because Ryanair’s minority stake did not constitute a concentration: its 29% shareholding did not confer “decisive influence”. Therefore, there was no relevant merger situation for review under the EUMR. Aer Lingus unsuccessfully appealed the Commission’s decision to the General Court, which again gave judgment on 6 July 2010.

On 29 October last year, the OFT announced that it had commenced an investigation into Ryanair’s minority shareholding (which it can do of its own volition where a merger situation exists under the UK rules).

Ryanair argued that the statutory time period for review by the OFT had elapsed and that the OFT should have begun its investigation in 2007 after the Commission’s decision to block the 100% share acquisition (when Ryanair’s shareholding was 25%). On 4 January 2011, the OFT issued a reasoned decision explaining why this was not the case. On 7 January 2011, Ryanair appealed to the CAT.

The CAT judgment

The CAT concluded that the OFT had a duty to avoid potential conflicts with EU law, based on the UK’s duty of sincere co-operation and the requirement under the EUMR that no member state shall apply its national competition legislation to a concentration in relation to which the Commission has accepted or claimed jurisdiction. It found that until the final determination of the appeals against the Commission’s decisions – ie 17 September 2010 – the OFT would have risked breaching EU legislation if it had commenced an investigation.

Analysis

It is not inconceivable that similar circumstances could arise in the EU and its member states in the future. It is not unusual for shareholders gradually to increase their stakes in companies. Moreover, other member states, including those with mandatory filing regimes (as opposed to the voluntary regime in the UK) have lower control thresholds than decisive influence.

In particular, companies should look out for member states which have both (1) a low control threshold to determine whether there is a reviewable concentration, and (2) a deal/party size thresholds that are easily met.

Germany is an example of such a member state, being known to trigger filing requirements regularly because of its low turnover thresholds. It has two tests (among others) which present a lower threshold than decisive influence. If either is met, the transaction is reviewable (subject to meeting the turnover test).

The first is the acquisition of 25% of a company's capital or voting rights. The second is the requirement to notify the acquisition of direct or indirect "competitively significant influence" over the target. In the 2008 A-Tec case, the Federal Cartel Office (FCO) ordered the dissolution of a merger that involved the acquisition of a 13.75% share in a company by a direct competitor. Although the acquirer did not have decisive influence over the target, the FCO held that the 13.75% share of a direct competitor was sufficient and provided an incentive to block decisions due to the typically low attendance at the shareholders' meetings.

Comment

It is everyday practice to consider the merger filing rules in multiple jurisdictions when a company wishes to acquire all of the assets or shares in another. In the EU, it is less common to have to consider notifying the acquisition of minority stakes than, for example, in the US, where merger filing obligations are not always determined by the issue of control. However, perhaps the Ryanair/Aer Lingus case ought to serve as a reminder that the rules of individual member states can differ from those prescribed by the EU (as well as from each other). When a transaction does not qualify as a concentration for review under the EUMR, companies should not rule out the possibility of review under the rules of member states.

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