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CLIENT ADVISORY

No Need for an Efficiency Defense if Conduct is not Anti-Competitive the CFI's Judgment in the *O2T-Mobile* Roaming Case

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INTRODUCTION

In a recent judgment, the European Court of First Instance ("CFI") annulled a decision by the European Commission ("Commission") exempting a national roaming agreement between O2 Germany and T-Mobile Deutschland (both mobile telecommunications providers) from the prohibition in Article 81-1 of the EC Treaty based on the efficiency defense provided by Article 81-3 of the EC Treaty.[1] The CFI held that there was no need to examine efficiencies under Article 81-3 EC because the Commission failed to demonstrate that the roaming agreement was anti-competitive within the meaning of Article 81-1 EC.

This judgment ("the *O2/T-Mobile* judgment") is important for the enforcement of EU antitrust policy in the telecom sector. In the CFI's view, the need to examine the concrete impact of an allegedly restrictive agreement on competition is indeed "particularly necessary as regards markets undergoing liberalisation".[2] The Commission will want to bear in mind this *caveat* if and when it launches a sector inquiry into the telecoms area.[3]

The *O2/T-Mobile* judgment also has wider implications for the enforcement of Article 81 EC as well as Article 82 EC. This client advisory will focus on these wider implications. It begins with a summary of the main principles governing

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1 Judgment of 2 May 2006 in case T-328/03, *O2 v Commission*, available at *http://www.curia.eu.int*. The Commission adopted the contested Decision on 16 July 2003 (O.J. L 75/32 of 12 March 2004).

2 See para. 72 of the judgment.

3 The EU Commissioner in charge of competition policy, Neelie Kroes, announced that such an enquiry might take place in 2007, after her speech on "Competition policy—2005 review, 2006 outlook" on 23 June 2006 (SPEECH/06/406). Incidentally, almost at the same time, EU Information Society Commissioner Viviane Reding announced an overhaul of the existing EU sector specific regulatory framework: see "The Review 2006 of EU Telecom rules: Strengthening Competition and Completing the Internal Market", (SPEECH/06/422). Both speeches are available at *http://www.ec.europa.eu/comm/competition/index_en.html*. More recently, Commissioner Reding hit the press again announcing the Commission's plans to cap international roaming charges, see press release IP/06/978 of 12 July 2006.

This summary is intended to be a general summary of various laws and regulations, and does not constitute legal advice. You should consult with competent counsel to determine applicable legal requirements in a specific fact situation.

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the application of Article 81-1 EC and Article 81-3 EC. It then describes the *O2/T-Mobile* roaming case. Last, it explains the wider implications of the case for the enforcement of Article 81 EC and Article 82 EC.

PRINCIPLES GOVERNING THE APPLICATION OF ARTICLE 81 EC

Article 81 EC contains a two-prong substantive legality test for the assessment of possibly anti-competitive agreements. Article 81-1 EC prohibits anti-competitive agreements in principle, while Article 81-3 EC provides that the prohibition will not apply to anti-competitive agreements that "have pro-competitive effects by way of efficiency gains".[4]

Traditionally, agreements have been found to restrict competition within the meaning of Article 81-1 EC when they distort the process of rivalry between competitors to an appreciable extent. Such a finding should be based on an examination of the economic and legal context in which the allegedly anti-competitive agreement has been concluded. For instance, an agreement that enables a new entrant to penetrate the relevant market may not restrict competition within the meaning of Article 81-1 EC.[5] The burden of proving an infringement of Article 81-1 EC is on the competent enforcement authority (i.e. the Commission or the national competition authority) or the party that asks a national court to apply this provision.[6]

Article 81-3 EC provides that "when the pro-competitive effects of an agreement outweigh its anti-competitive effects, the agreement is on balance pro-competitive".[7] The burden of proof is, however, on the companies to demonstrate that their agreement generates efficiencies in the interest of consumers and that these efficiencies outweigh the distortion of the process of rivalry.[8]

The balancing of the agreement's pro-competitive and anti-competitive effects can only take place in the analysis under Article 81-3 EC.[9]

THE *O2/T-MOBILE* ROAMING CASE

Regulatory framework for roaming

In December 1998, the European Parliament and the Council adopted a Decision concerning the introduction of a third generation ("3G") mobile communications system in the Community.[10] These 3G systems are also called universal mobile telecommunications systems, in short "UMTS".[11]

The Commission adopted a Communication in March 2001 encouraging the telecom operators to share each other's infrastructure because it acknowledged the difficult financial situation of telecom operators in the EU and the high infrastructure investment costs involved in the development of 3G mobile communications.[12]

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4 See Commission Notice containing guidelines on the application of Article 81-3 EC, O.J. C101/97 of 27 April 2004, para. 33.

5 Cf. judgment of 13 June 1966 in case 56/65, *Société Technique Minière/ Maschinenbau Ulm*, [1966] ECR 235, at 249-250.

6 Cf. Article 2 of Council Regulation No. 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty which entered into force on 1 May 2004, O.J. L 1/1 of 4 January 2003.

7 Cf. footnote 4.

8 Cf. footnote 6.

9 Cf. judgment of 15 September 1998 in cases T-374/94, T-375/94, T-384/94 and T-388/94, *European Night Services and others v. Commission*, [1998] ECR II-3141, para. 136.

10 For a presentation of the Commission's Decision, cf. Gabathuler and Sauter, "Network sharing in 3rd generation mobile telecommunications systems: minding the coverage gap and complying with EC competition rules", in the Commission's Competition Policy Newsletter, Number 3 (2003), p. 43.

11 Decision 1999/28/EC, O.J. L 17/1 of 22 January 1999.

12 COM (2001) 141 final. See also, more recently, Communication from the European Parliament, the European Economic and Social Committee and the Committee of the Regions « Mobile Broadband Services », COM (2004) 447 final.

In March 2002, the European Parliament and the Council adopted a Directive concerning access to, and interconnection with, electronic communications networks and services.[13] This Directive refers to mobile network roaming, an arrangement through which the cooperating telecom operators do not share their networks, but simply use each other's network to provide services to their own customers. The Directive requires network operators to enter into good faith negotiations with companies that seek access to their networks (Article 4) and it requires national regulatory authorities to "encourage, and where appropriate, ensure adequate access" (Article 5). Thus, the Directive implicitly promotes roaming.

The Facts

In 2000, O2 Germany was the fourth operator to obtain a 3G license in Germany. Under the national regulatory framework, O2 was required to offer a network covering 50% of the population by the end of 2005. In order to achieve this, O2 entered into an agreement with T-Mobile Deutschland to share some parts of their network and offer 3G roaming services to each other's customers.

Under the roaming agreement, O2 would roam on T-Mobile's network in the most populated urban areas —which represented 50% of the population—until it was able to achieve sufficient network quality and density to compete effectively with the three other licensed network operators, including T-Mobile. Elsewhere in Germany, O2 and T-Mobile would each have the option to roam on the other's network. Given that T-Mobile's network was more extensive and that it is obviously more economical for a network operator to use its own network, O2 would predominantly roam on T-Mobile's network, not the other way round.

The Commission's Assessment

While the Commission raised no issue regarding the limited network sharing, it did challenge the roaming agreement. According to the Commission, the roaming agreement restricted "by definition" competition within the meaning of Article 81-1 EC. In its view, the roaming agreement inevitably led O2 and T-Mobile to offer similar network coverage as well as similar speed, quality and price of data transmission. In addition, the roaming agreement would constrain O2's pricing policy towards its own customers because O2 would be paying wholesale rates for access to T-Mobile's network.[14]

The Commission nevertheless exempted the roaming agreement pursuant to Article 81-3 EC. Referring repeatedly to the "business case" for 3G networks, it observed that in the absence of its roaming agreement with T-Mobile, O2 Germany would not have been able to offer the same network coverage as quickly and efficiently. In this respect, the Commission noted that O2 was the smallest of the four licensed 3G mobile operators in Germany with a limited customer base and more limited access to financial resources than its competitors.[15] With its reference to "the business case" for 3G networks, the Commission in fact suggested that O2 would probably not have been able to enter the market successfully on a stand-alone basis. It also explicitly observed that the roaming agreement did not substantially lessen competition. First, the agreement left O2 and T-Mobile enough margin to differentiate their services. Second, competition between all four licensed operators would actually be "enhanced" by the roaming agreement.[16]

O2 nevertheless sought the annulment of this Decision because the Commission had granted the exemption only for a limited period of time.[17]

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13 Directive 2002/21/EC, O.J. L 108/7 of 24 April 2002.

14 Cf. para. 107 of the contested Decision.

15 Id., paras 132 and 133. Cf. also paras. 123 and 126.

16 Id. see respectively paras. 137 and 138.

17 The duration of the exemption varied according to the geographic area covered by the roaming arrangement. For details, see Article 2 and Article 3 of the contested Decision.

The CFI's Findings

The CFI annulled the exemption Decision, essentially because the Commission had not examined—under Article 81-1 EC—what the state of competition in the relevant market would have been *in the absence of* the roaming agreement between O2 and T-Mobile. The CFI held that this was an error because "an examination in this respect was necessary not only for the purposes of granting an exemption but, prior to that, for the purposes of the economic analysis of the effects of the agreement on the competitive situation determining the applicability of Article 81 EC".[18]

The CFI then evaluated the Commission's analysis under Article 81-1 EC and found it insufficient. This analysis contained only a description of features that were common to all roaming agreements, and the Commission simply *assumed* that these generic features restricted competition between the roaming operator and the visited operator in the case at hand.[19]

According to the CFI, such a sweeping assumption was simply not good enough. There were indeed several factors suggesting that the roaming agreement did not restrict competition between O2 and T-Mobile and that it was perhaps even pro-competitive.

Most fundamentally, the Commission itself had accepted under Article 81-3 EC that in the absence of the agreement, O2 would not have been able to gain access to the market efficiently. Hence, "O2's competitive situation on the 3G market would probably not have been secure without the agreement, and it might even have been jeopardized".[20]

The CFI rejected the Commission's attempt to distinguish between a company's complete inability to penetrate the market alone (where the Commission conceded that Article 81-1 EC would not apply to the agreement) and a company's ability to do so, albeit with difficulty (where the Commission argued that Article 81-1 EC should apply to the agreement, with efficiencies analysed pursuant to Article 81-3 EC). The CFI rejected this subtle distinction and concluded that the Commission's analysis under Article 81-1 EC had been "confined to a *petitio principii"* (i.e. that it was in fact circular).[21]

THE TEACHING OF THE *O2/T-MOBILE* JUDGMENT

The CFI rarely annuls exemption decisions given the established case law affording the Commission a large margin of discretion when it vets agreements under Article 81-3 EC. But the *O2/T-Mobile* case is one of these rare exceptions to this general rule. Moreover, it is the first case in which the CFI has annulled an exemption decision because the Commission failed to explain why the agreement was anti-competitive under Article 81-1 EC in the first place.

The judgment is interesting for two reasons. First, the CFI reminds us that the Commission cannot simply assume that a particular agreement is anti-competitive within the meaning of Article 81-1 EC without assessing its concrete impact on competition in the relevant market(s). This analysis cannot take place in a vacuum. It requires a comparison of the state of competition after the agreement has been concluded with the competitive situation that would have existed in the absence of the agreement.

Second, in its Discussion Paper on the application of Article 82 EC to exclusionary abuses[22], the Commission proposes to apply Article 81-3 EC by analogy to dominant companies so as to give them an opportunity to justify their exclusionary conduct as efficiency-enhancing. By analogy, the CFI's judgment in the *O2/T-Mobile* warns the Commission not to assume that the dominant company's conduct is exclusionary, but rather requires the Commission to examine any alleged foreclosure effects of such conduct in a concrete market context.

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18 Cf. para. 79 of the judgment.

19 Id., para. 85-86.

20 Id., para. 114. Cf. also para. 78.

21 Id., para. 115-116.

22 This Discussion Paper was published in December 2005, and is available at *http://www.ec.europa.eu/comm/competition/index_en.html*. The Commission is likely to adopt draft guidelines on its enforcement of Art. 82 by the end of 2006.

As a consequence, the *O2/T-Mobile* judgment has important practical consequences for the issue of burden of proof: the Commission must first adduce concrete evidence of a possible infringement of Article 81-1 EC or Article 82 EC before shifting the burden to companies to prove that their conduct is on balance pro-competitive.

We expand on these considerations below.

The Substantive Legality Test Under Article 81 EC

The Commission's decision in *O2/T-Mobile* is consistent with its historic approach to Article 81 EC. Under this approach, the Commission would usually find a restriction of competition within the meaning of Article 81-1 EC whenever parties to an agreement restricted their commercial freedom (thus distorting the process of rivalry between competitors). The Commission would then adopt a less formalistic approach under Article 81-3 EC, assessing the agreement in its market context and weighing up any potential restraints against the efficiencies generated by it.

A classic example of such an approach is the Commission's exemption Decision in the joint venture case *Ford/Volkswagen*.[23] The Commission found a restriction of competition under Article 81-1 EC, observing that each company could have entered the relevant market alone. The Commission nevertheless granted an exemption pursuant to Article 81-3 EC for a limited period of time on the ground that the agreement had enabled both parties to enter the market more rapidly and more efficiently. In fact, the Commission implicitly conceded that there would not have been a business case for either Ford or Volkswagen to enter the market alone. It nevertheless imposed a series of conditions and obligations on the two parties in order to limit the alleged restriction of competition between them. The CFI upheld the Commission's Decision.[24]

As the *Ford/Volkswagen* case illustrates, the Commission used to favor the application of Article 81-3 EC over an extensive analysis under Article 81-1 EC because Article 81-3 EC gave it two powers not available under Article 81-1 EC: the power to attach obligations and conditions to the exemption (Cf. *Ford/Volkswagen*) and the power to limit the exemption in time (Cf. *O2/T-Mobile* and *Ford/Volkswagen*).

Today, these two powers—which were both linked to the Commission's exclusive power to grant exemptions—are gone. Since Council Regulation No 1/2003 entered into force, the Commission, the national competition authorities and the national courts share the power to apply Article 81 EC in its entirety, including Article 81-3 EC. Moreover, the application of Article 81-3 EC in a given case can no longer be qualified by obligations, conditions and time limitations.

With this procedural change there is no longer any reason for the Commission to prefer to exempt transactions under Article 81-3 EC rather than to find no infringement of Article 81-1 EC. But the *O2/T-Mobile* judgment adds a sound competition policy rationale for abandoning the Commission's formalistic approach to Article 81-1 EC.

While the result in *O2/T-Mobile* was the same under both the Commission's approach of relying on Article 81-3 EC and the CFI's finding that the Commission had not adduced compelling evidence of an infringement of Article 81-1 EC, the CFI's judgment nonetheless has important tactical implications. Under Article 81-1 EC, the Commission bears the burden of proving anti-competitive effects, while under Article 81-3 EC, the parties to the agreement bear the burden of showing efficiencies that outweigh these anti-competitive effects. By forcing the Commission to abandon its formalistic approach to Article 81-1 EC, the CFI's judgment makes it more difficult for the Commission to put parties to an agreement on the defensive.

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23 Decision No 93/49, OJ L20, 28 January 1993, p. 14.

24 Cf. judgment of 15 July 1994 in case T-17/93 *Matra Hachette v Commission* [1994] ECR II-595.

The Substantive Legality Test Under Article 82 EC

In its Discussion Paper, the Commission proposes to offer dominant companies the opportunity to justify their anti-competitive conduct by demonstrating that this conduct meets the conditions set forth in Article 81-3 EC.

Elsewhere we have expressed some skepticism about a dominant company's chances to advance such an efficiency defense successfully. [25]

However, the point to be made here is that the *O2/T-Mobile* judgment constitutes a welcome reminder that any assessment of an efficiency defense under Article 81-3 EC—be it with regard to an agreement within the meaning of Article 81-1 EC or with regard to allegedly exclusionary conduct within the meaning of Article 82 EC—must be preceded by a careful examination of the impact of the agreement or the conduct on the process of competition in the relevant market.

To put it differently, a dominant company should not be asked to prove that the pro-competitive effects of its allegedly exclusionary conduct (in terms of enhanced efficiencies) outweigh its anti-competitive effects (in terms of reduced rivalry in the competitive process), if there is no solid evidence that there is a restriction of competition in the first place.

If you have questions about this advisory, or other related issues, please feel free to contact your Arnold & Porter attorney or:

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[25] Cf. Client Advisory "Comments on the European Commission's Discussion Paper on the Application of Article 82 EC Treaty to Exclusionary Abuses", May 2006.