SLAUGHTER AND MAY

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General Court requires the European Commission to re-examine Lufthansa's request to waive merger condition

The General Court of the European Union (GC) partially annulled a decision of the European Commission to refuse a waiver of pricing commitments entered into by Lufthansa when it acquired control of Swiss International Airlines in 2005. The relevant commitments applied to two routes operated by Swiss.

In its **judgment** handed down on 16 May 2018, the GC concluded that the Commission had made a manifest error of assessment inasmuch as it failed to take into account all the relevant information, and that the matters relied on in its decision were not capable of justifying the rejection of the waiver request in relation to one of the relevant routes.[1] The Commission must now re-examine the request in relation to that route.

The ruling constitutes a setback for the Commission, and may embolden merging parties to dispute Commission decisions with which they disagree before the EU courts. However, this ruling is specific to its facts and market context, and cannot be read as a fundamental challenge of the Commission's practice in relation to commitments more generally.

Lufthansa / Swiss – the 2005 merger decision

In 2005 the Commission **cleared** – subject to a package of conditions – the planned acquisition of control of Swiss by Lufthansa (the 2005 decision).[2] The conditions included "fare commitments" in relation to the Zurich-Stockholm and Zurich-Warsaw routes operated by Swiss. These fare commitments required that, whenever the parties reduced a published fare on a comparable reference route, they must also apply an equivalent fare reduction on the two routes of concern.

The Commission decided that these conditions were necessary as part of its clearance of the transaction due to competition concerns in relation to Star Alliance operations on each of these routes. Aside from Swiss, the only other airlines serving these routes were SAS (for the Zurich-Stockholm route) and LOT

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[1] Case T-712/16 *Deutsche Lufthansa AG* v *Commission*, judgment of 16 May 2018.
[2] Case M.3770 – *Lufthansa / Swiss* decision of 4 July 2005.

(for the Zurich-Warsaw route). Both SAS and LOT were Star Alliance members. The Commission found that Swiss was likely to join Star Alliance – of which Lufthansa was a founding member – as indeed it subsequently did. In addition to their shared membership of Star Alliance, Lufthansa had a number of cooperation agreements with SAS and LOT; including a codesharing, marketing and sales and joint venture agreement entered into with SAS in 1995 (the SAS JV). The Commission therefore concluded that SAS and LOT would have little incentive to compete with Swiss once the transaction had taken place.

The fare conditions were stipulated to cease if a new air service provider began operations on the routes concerned. The commitments also contained a review clause, allowing the Commission to waive, modify or substitute the commitments based on "exceptional circumstances or a radical change in market conditions," or "long-term market evolution".

The parties' request for a waiver of the fare conditions

In November 2013 Lufthansa and Swiss submitted a request to the Commission seeking (amongst other things) a waiver of the fare conditions in relation to the Zurich-Stockholm and Zurich-Warsaw routes. The parties argued that since the 2005 decision the SAS JV had been terminated, giving rise to a material change in the contractual relationship between the parties. In addition, the parties argued that since the 2005 decision the Commission had changed its treatment of alliance partners in its assessment of airline mergers. The Commission did not view alliance partnerships as restricting competition in the factually similar 2009 Lufthansa/Brussels Airlines case. Finally, the parties argued that there was in fact competition between Swiss and SAS and LOT respectively on the affected routes.

Commission decision and Lufthansa's appeal to the GC

When in July 2016 the Commission rejected the parties' request, taking the view that conditions for a waiver were not met, Lufthansa brought an action before the GC. The GC issued its judgment on 16 May 2018, annulling the Commission's decision insofar as it related to the Zurich-Stockholm route, but dismissing Lufthansa's application insofar as it related to the Zurich-Warsaw route.

The GC judgment

In its judgment the GC emphasised that the Commission has a certain discretion in its assessments under the EU Merger Regulation (EUMR), especially with respect to assessments of an economic nature. This discretion also applied in relation to the need for and implementation of commitments, and in relation to a request for a waiver entailing complex economic assessments.

However, the GC emphasised that this discretion is not unlimited. In particular, the Commission must carry out a careful examination of a request for a waiver; it must conduct, if necessary, an investigation; it must make the appropriate enquiries; and it must base its conclusions on all the relevant information. The GC also noted that once the parties applying for a waiver have submitted sufficient evidence to support their request, it is then for the Commission to show how the evidence is insufficient or unreliable and, if necessary, carry out an investigation to verify, supplement or refute that evidence.

The GC found that the Commission had not met this standard in reaching its decision to reject Lufthansa and Swiss' request for a waiver. For example, it found that the Commission did not answer the parties'

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submission regarding a change in policy in relation to the treatment of alliance partners in its assessment of overlaps. Furthermore, the GC concluded that the Commission failed to examine the impact of termination of the SAS JV, and accordingly did not take into account all the relevant elements for the assessment of the waiver request based on a change in the contractual relationships between Lufthansa and SAS.

In light of these failings, and given the contractual changes between Lufthansa and SAS, the GC annulled the Commission's decision as it related to that route. However, in the absence of any equivalent contractual changes affecting the Zurich-Warsaw route, the GC allowed the Commission's decision as it relates to that route to stand.

What does this mean for other merging parties?

This ruling adds to a growing list of instances in which parties have successfully challenged the Commission's decisions in merger cases. While historically merging parties have sometimes been reluctant to challenge Commission merger decisions before the EU courts, this decision may contribute to a change in that attitude.

However, merging parties must resist the temptation to read too much into this judgment. It is by its nature very specific to the facts of the underlying case and the prevailing market conditions. It is also notable that the GC did not find any evidence of alleged bias on the part of the Commission, nor that it altogether failed to consider the waiver request as argued by Lufthansa. The GC also rejected Lufthansa's allegation that the Commission used the waiver procedure as leverage to force Swiss to terminate a contractual arrangement that had no clear nexus to the transaction. Suggestions by the Commission that the Swiss-LOT codeshare agreement should be modified or terminated were viewed by the GC as merely standalone remarks in light of wider market competition issues with no direct bearing on the waiver decision. Finally, as noted above the GC was at pains to emphasise the discretion afforded to the Commission in relation to assessments carried out under the EUMR.

Merging parties are therefore still likely to find that proactive and constructive engagement with the Commission remains the most effective way to deal with disagreements regarding commitments.

Other developments

Merger control

European Commission conditionally clears ArcelorMittal/Ilva after Phase II

On 7 May 2018 the European Commission **announced** that it had conditionally approved ArcelorMittal's acquisition of Ilva. Following an in-depth Phase II investigation the Commission cleared the proposed transaction subject to commitments from the parties to divest European assets, including production plants in six countries and certain distribution facilities in France and Italy.

The deal combines the largest producer of flat carbon steel in Europe and worldwide, ArcelorMittal, with the main assets of the largest steel producer in Italy, Ilva. The proposed transaction was formally notified

to the Commission on 21 September 2017. A Phase II investigation was opened on 8 November 2017 following Commission concerns that the transaction would lead to higher prices for European customers for hot rolled, cold rolled and galvanised flat carbon steel.

The Phase II investigation found that the merged entity would account for more than 40 per cent of the production capacity of certain steel products in the EEA (a much higher share than any of its competitors in Europe), and that competitors would have neither the incentive nor the ability to replace competition lost as a result of the transaction. The Commission found that imports from third countries can act as a significant competitive constraint on the European market for hot rolled steel and to a lesser extent for cold rolled and galvanised steel. However, it concluded that imports did not provide a sufficiently strong alternative to fully offset the likely negative effects on price due to the loss of competition between ArcelorMittal and Ilva.

Accordingly, the Commission made its approval conditional on the full implementation of a remedy package to preserve effective competition on European steel markets. The package includes the sale of varying amounts of production capacity across the markets for hot rolled, cold rolled and galvanised steel. In addition, ArcelorMittal agreed to remove a significant Italian competitor (Marcegaglia) from the consortium purchasing Ilva and committed not to acquire shares in Marcegaglia as part of the transaction to avoid any further weakening of competition by a strengthening of structural ties between the three companies.

ArcelorMittal is to organise the sale of the divestment assets to one or more buyers that will continue to operate and develop them, so they can compete effectively with the merged entity on a lasting basis.

Antitrust

European Commission issues roadmap for the evaluation of the future of the liner shipping consortia block exemption

The European Commission is considering the future of the liner shipping consortia block exemption regulation (BER) (**Commission Regulation (EC) 906/2009**), which will expire on 25 April 2020. On 7 May 2018 the Commission published a **roadmap** outlining its planned evaluation process.

Under the BER; shipping lines with a combined market share of below 30 per cent per trade are allowed to enter into agreements to provide joint cargo transport services, such as the co-ordination of timetables; the exchange, sale or cross-chartering of space or slots on vessels; the pooling of vessels / port installations; and the joint operation or use of port terminals and related services.

Since the introduction of the first consortia BER in 1995 (which has since been extended and amended four times), the Commission has progressively repealed maritime-specific competition legislation and guidelines as part of its policy of harmonising competition rules - the BER is the only remaining measure. The Commission has instead provided general guidance on the application of Article 101 of the Treaty on the Functioning of the European Union (TFEU).

While the tone of the roadmap is neutral as to the BER’s future, today’s backdrop differs greatly from 1995. The industry has seen a wave of alliances and M&A in recent years, which some argue means liners have greater scale to operate efficiently without needing to co-operate with other market players. As a

result, the Commission intends to conduct a robust assessment of the BER against the criteria set out in its roadmap: effectiveness; efficiency; relevance; coherence; and EU added value. In the event that the BER is not renewed, or is substantially amended, consortia agreements will not necessarily breach Article 101 nor be incapable of objective justification under Article 101(3). However, liners would be required to undertake a more detailed self-assessment of the agreement's market effects.

The Commission aims to launch a public consultation on the topic in Q3 2018, followed by the publication of a Staff Working Document in Q4 2018.

General Competition

CMA publishes update paper recommending regulation of domestic heat networks

The Competition and Markets Authority (CMA) **announced** its recommendation to regulate the UK's heat network sector in its **update paper** published on 10 May 2018. The CMA is of the opinion that regulation would help to protect customers from the potential negative effects of monopoly suppliers.

The heat networks market involves the generation and distribution of thermal energy to multiple properties, including both district and communal heating, for the purposes of heating, cooling or hot water. There are around 14,000 networks in the UK. The CMA has found that even though for many customers heat networks offer prices which are the same or lower than for gas or electricity, some customers – mainly those living in privately owned or rented properties – pay more through a heat network. The CMA's market study has focused exclusively on these residential customers.

In its initial findings the CMA highlighted its concerns surrounding a lack of competitive pressure on suppliers. The CMA acknowledged issues such as the lack of alternative sources of heat and customers potentially being locked into long term contracts. Further concerns were low transparency as to whether a property is supplied by a heat network, and issues relating to design and build – referring to the fact that some property developers may try to cut the upfront costs of installing a network, resulting in higher ongoing costs to be borne by customers.

To address these concerns the CMA expressed its provisional view in favour of regulating the sector. It suggests that regulation would involve, for example: (i) a complaints handling procedure and access to an ombudsman; (ii) support for vulnerable customers; (iii) all suppliers adhering to mandatory rules and criteria around price and quality in long-term contracts; and (iv) measures to improve transparency including better information on networks, provision of heat supply agreements or contracts, and clearer and more detailed bills.

The CMA **decided** not to refer the matter for an in-depth market investigation. It has opened a consultation on possible remedies and interested parties can provide their feedback on the update paper until 31 May 2018. The CMA's final report is expected in summer 2018.

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Brussels	London	Hong Kong	Beijing
T +32 (0)2 737 94 00	T +44 (0)20 7600 1200	T +852 2521 0551	T +86 10 5965 0600

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