Telefonica’s acquisition of E-Plus, if approved, will turn Germany into a fiercely competitive market

Consolidation in Germany – Lessons learned from Austria

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Telefonica’s acquisition of E-Plus, if approved, will turn Germany into a fiercely competitive market...

- The European Commission’s analysis of the Austrian merger case was inadequate

- Key arguments that led to the approval of the merger were flawed

- Telefonica’s acquisition of E-Plus could only be approved if a fourth national mobile network operator enters the market

- In the absence of a new operator entry, Telefonica’s acquisition of E-Plus should not be approved on the sole basis of an Austrian-like toothless MVNO wholesale access remedy...

- ...but rather on the condition that Telefonica must become post-merger a truly competitive mobile-only operator force by divesting all its fixed-line assets and by maximising the utilisation of its spectrum holdings
Most think that Telefonica’s acquisition of E-Plus is only about...

No! It is much more than protecting mobile revenues in the German mobile market!

... the consolidation benefits (i.e. higher prices) set off by the increased concentration in the German mobile market
It is about protecting revenues... 

...across the Group European footprint in the two relevant retail product markets a) the smartphone and b) the broadband connectivity markets...
Few words about the German broadband market...

If the merger is approved, DT, VOD and TEF with Liberty’s cooperation will seal the broadband (fixed+mobile) infra market in Germany.
Consolidation in Austria – Lessons learned part 1...

- Using a narrow and outdated definition of relevant product markets the Commission’s investigation was limited only to non-coordinated effects in the relevant mobile markets i.e. increased concentration (market shares)

- The Commission ignored entirely non-coordinated effects likely to impede effective competition driven by the interest of market players to protect domestic revenue from a related market (i.e. fixed broadband) or group wide mobile revenue across their European footprint
Consolidation in Austria – Lessons learned part 2...

- The Commission first concluded that the **MVNO wholesale access commitment** would not eliminate the competition concerns and the transaction would lead to a significant impediment to effective competition. So it mandated a structural remedy i.e. commitments that would lead to new network operator entry.

- When in the end it faced the Austrian competition authority’s (BWB) criticism that a new entry was very unlikely the Commission **made a sudden U-turn** and argued that the MVNO wholesale access commitment **would** eliminate *after all* the competition concerns and the transaction would *not, after all*, lead to a significant impediment to effective competition.

Uncertain new entry + toothless MVNO remedy = Unconditional merger approval

Key arguments that led the Commission to approve the merger by accepting Hutchison’s commitments were flawed.
Incumbent operators with fixed-line interest, if allowed, will resort to pre-emptive anti-competitive practices i.e. spectrum hoarding with the aim to weaken mobile competitors and suppress the potency of merger remedies.

“This fully supports Telekom Austria Group’s high value strategy and network quality leadership and allows Telekom Austria Group to protect its fixed-line as well as its mobile customer base, in particular in rural areas. Moreover, the spectrum distribution has significantly reduced the viability of a potential new mass market mobile virtual network operator (MVNO)” Telekom Austria CEO written statement.

Hoarding has four dimensions:

- **Access**: An operator acquires more than what is necessary in a critical band to prevent competitors from gaining access to that band.
- **Coverage**: An operator acquires blocks or entire bands of spectrum and does not roll them out on time.
- **Allocation share (MHz/customer)**: Operator spectrum share versus its market share.
- **Utilization (GB/MHz or GB/customer)**: Mobile data consumption per customer.

The utilization dimension is the most critical dimension of hoarding and it has been totally overlooked by NRAs and by the European Commission.
The lowest available smartphone tariff GB price (€3) in the German market will almost double (+73%) if Telefonica, post-merger, was allowed to simply discontinue E-Plus BASE tariffs. 

The trend line slope shows the approximate variable, GB volume dependent price while the crossing point on the Y axis marks the approximate data-traffic independent fixed tariff charge. 

MNO discount brands offer lower prices only for very small GB allowances (up to 1GB) appealing only to light users. Their GB variable charge is almost 200% higher than the rates that their parents charge!
The facts about the German protected oligopoly market part 2...

In the German protected oligopoly GBs cost 445% more than in the UK’s competitive market.
Operators in UK’s competitive market did pass LTE’s lower unit cost (€/GB) on retail benefitting consumers and the wider digital economy. On the contrary, in the German protected oligopoly operators have NOT passed the LTE lower unit cost (€/GB) on retail but rather used LTE as an opportunity to collectively raise prices.
The GB pricing (€0.04) of mobile broadband connectivity in Finland and Denmark is lower than Deutsche Telekom’s GB pricing (€0.07) of fixed DSL and fibre broadband in Germany (!!!)

The facts about the German protected oligopoly market part 4...
The facts about the German protected oligopoly market part 5...

If Telefonica and E-Plus merger was cleared Telefonica will become the biggest MNO in Germany with 38% share. As the market leader will it apply the Spanish or the UK GB prices?

Telefonica's GB pricing in the German and Spanish protected oligopolies versus UK

Smartphone tariffs with unlimited minutes and SMSs

The trend line slope shows the approximate variable, GB volume dependent price while the crossing point on the Y axis marks the approximate data-traffic independent fixed tariff charge.

Telefonica Spain (Movistar no.1-42% SIM share) \( y=12.100x+30.250 \)

Telefonica Germany (o2 no.3-17% postmerger no.1-38%) \( y=6.3353x+23.123 \)

Telefonica UK (o2 no.2-30% SIM share) \( y=2.5903x+23.154 \)

Source Rewheel premium report October 2013

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Narrow outdated definition of relevant product markets biases the outcome of competition analysis...

According to the Commission’s assertion in the Austrian merger; mobile broadband can substitute fixed broadband but the opposite is not true. So they do not form part of the same product market. So the Austrian merger was reviewed under the Horizontal Guidelines and the strategic interest of the market players from the related fixed broadband market were fully ignored.

Flat LCD screens as a newer more advance technology could substitute the bulky CRT screens because they offer the same function, video projection, but with an additional consumer benefit i.e. there are flat not bulky. The same is true for mobile broadband, as a newer more advanced technology it could offer broadband connectivity with an additional consumer benefit i.e. full mobility.

Well this technicality did not stop the producers of both bulky CRT and flat LCD screens to form a cartel and fix prices in order to protect revenues from an old technology. It neither stopped the Commission handing down to them a record 1.47 billion EUR fine.

The Commission could define a related product market for fixed-line and mobile broadband under the Non-horizontal Guidelines

Related: “range of products that is generally purchased by the same set of customers for the same end use”
Factors that will impede effective competition in Germany

- Increased concentration in the smartphone connectivity market
- Prevent fixed-line broadband revenue erosion in the domestic market from the threat of mobile broadband substitution
- Prevent group wide revenue erosion across the European footprint

**Factors that will impede effective competition in Germany**

**Cross-border consolidation | Perfect platform for a pan-European ring of 4?**

**E4 buyout all independent challenger MNOs and regional incumbents for 100% share?**

<table>
<thead>
<tr>
<th>Country</th>
<th>Ring-share</th>
<th>Competition</th>
<th>Customer Share</th>
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<tbody>
<tr>
<td>France</td>
<td>45.0%</td>
<td>65.0%</td>
<td>55.0%</td>
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<tr>
<td>Germany</td>
<td>35.0%</td>
<td>55.0%</td>
<td>45.0%</td>
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<tr>
<td>Spain</td>
<td>50.0%</td>
<td>70.0%</td>
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<tr>
<td>UK</td>
<td>40.0%</td>
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The state owned ex-monopolies and their friends pushing convergence win, EU consumers and digital economy lose.

The undisputed evidences of weak competition in the German mobile market, the structure of the broadband market and the European interest of the three operators warrants an all-out merger investigation and truly effective merger commitments (remedies).
Conditions that may allow the Commission to approve Telefonica’s acquisition of E-Plus

- The condition for approving Telefonica’s acquisition of E-Plus shall be the immediate fourth national network operator entry. For the avoidance of doubt, the condition is the actual entry and not Telefonica’s offered commitments that might enable the entry (e.g. spectrum divestments)
  - Spectrum divestment obligation (2x5MHz 900MHz and 2x17.4MHz 1800MHz and 2x10MHz 2100MHz)
  - 7 year national roaming obligation (€0.01 per minute, €0,004 per SMS and €0.002 per MB)
  - Site collocation and site divestments

- In the absence of a new operator entry, Telefonica’s acquisition of E-Plus should not be approved on the sole basis of an Austrian-like toothless MVNO wholesale access remedy but rather on the condition that Telefonica must become post-merger a truly competitive mobile-only operator force by divesting all its fixed-line assets and by maximising the utilisation of its spectrum holdings
  - Obligation: commit, for a period of 3 years from the date that the Commission has conditionally approved the merger, not to raise prices across all of its retail brands and as well E-Plus acquired brands neither by means of increased charges on existing contracts nor by other indirect means such as by launching a new portfolio of tariffs, with the aim to replace tariffs that were on sale before the merger approval, where the allowances are different but which result in a price increase for a significant amount of customers
  - Obligation: commit, for a period of 7 years from the date that the Commission has conditionally approved the merger, to meet minimum spectrum utilization targets (GB/MHz) “use it or lose it”. The committed minimum spectrum utilization thresholds (GB/MHz) and detailed methods for verifying such targets shall be proposed by Telefonica and approved by the Commission and Bundesnetzagentur prior to the conditional approval of the merger

Rather that getting precisely wrong, as it did in Austria, the Commission should aim to get it roughly right in Germany
Thank you

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Rewheel is specialised into being in the forefront of the mobile data transformation

Since 2009 we have advised over 10 European mobile operators, including independent players and Tier-1 OpCos, as well as several regulators and a number of private equity and institutional investors and various mobile-date centric startups.

Since the onset of the mobile broadband centric 900, 1800 and 2100 MHz license renewal avalanche in 2011 in Europe we have been providing strategy, spectrum valuation and auction theory advice (together with our world class CCA/SMRA auction theorist partners) to five European award processes (operator or regulator side depending on country), including new entrants and acquisitions as well as license renewals in multi-band (typically 800,900,1800,2100 and 2600 MHz) auctions. So far our advisory support has been directly impacting over EUR 1bn of European spectrum investments/state proceeds.