Telefonica's Mickey Mouse commitments are irrelevant and ineffective

Will Almunia succumb to Merkel's pressure and clear Telefonica/E-Plus merger with toothless Austrian like remedies (leased 2600MHz spectrum, WiFi, MVNOs) or stand firm, enforce the law and prohibit the merger?

Rewheel/Digital Fuel Monitor analysis, 12th May 2014

We have previously concluded, in a number of reports and research bulletins which are included in the file of the proposed merger between Telefonica o2 Deutschland and E-Plus (Case M.7018) that;

- The only remedy that has the potential to eliminate the competition concerns entirely and could be effective from all points of view, as the law requires, is the actual market entry of a new credible independent 4th challenger MNO. **Therefore the approval of the merger should be conditioned on the actual market entry of a new 4th challenger MNO**. If no credible MNO entry materializes the Commission must enforce the law and block the merger.

Telefonica, following the Commission's Statement of Objections, has submitted a set of initial commitments. Telefonica submitted a revised "sweetened" set of commitments after the conclusion of the first Market Test. In this analysis we discuss the real motive behind the telco consolidation push, we put Telefonica's revised commitments to the test by scrutinizing their relevance/effectiveness and we conclude by laying out a set of effective commitments that could, if materialize, remedy the impediment to effective competition.

Why telcos are so eager to consolidate? Is there more to it than making the revenue share bigger for the post-consolidation MNOs?

Consolidation will make the revenue pie bigger for the remaining MNOs. On top of that consolidation, as we shown in Austria, will lead to higher prices. **Higher mobile connectivity access prices will harm consumers and slow down the growth of the digital economy.** Higher prices will slow down adoption, suppress usage, and curtail e-commerce growth.

However, what telcos really hope is that consolidation would allow them to grab a share of the over-the-top (OTT) video, cloud, pay TV and social-media business which are going mobile. But how would telcos become the gatekeepers and foreclose these lucrative OTT markets?

- By **overpricing open mobile internet access connectivity** (severely restrict the affordable Gigabyte volume allowance). This is already happening in the German mobile market even though there are currently four MNOs. Smallest share challenger operators, eager to grow their market share and fill up their network have every incentive to offer to consumers what they are looking to buy; **affordable net-neutral open mobile internet access.** E-Plus as part of the incumbent KPN group is clearly not one of them as shown at http://www.dfmonitor.eu/KPN/
- By exempting, discounting, sponsoring, rebating or **zero-rating the volume from the end-users allowance that their own or their OTT partner's applications generate thus placing all 3rd party apps at a competitive disadvantage.**

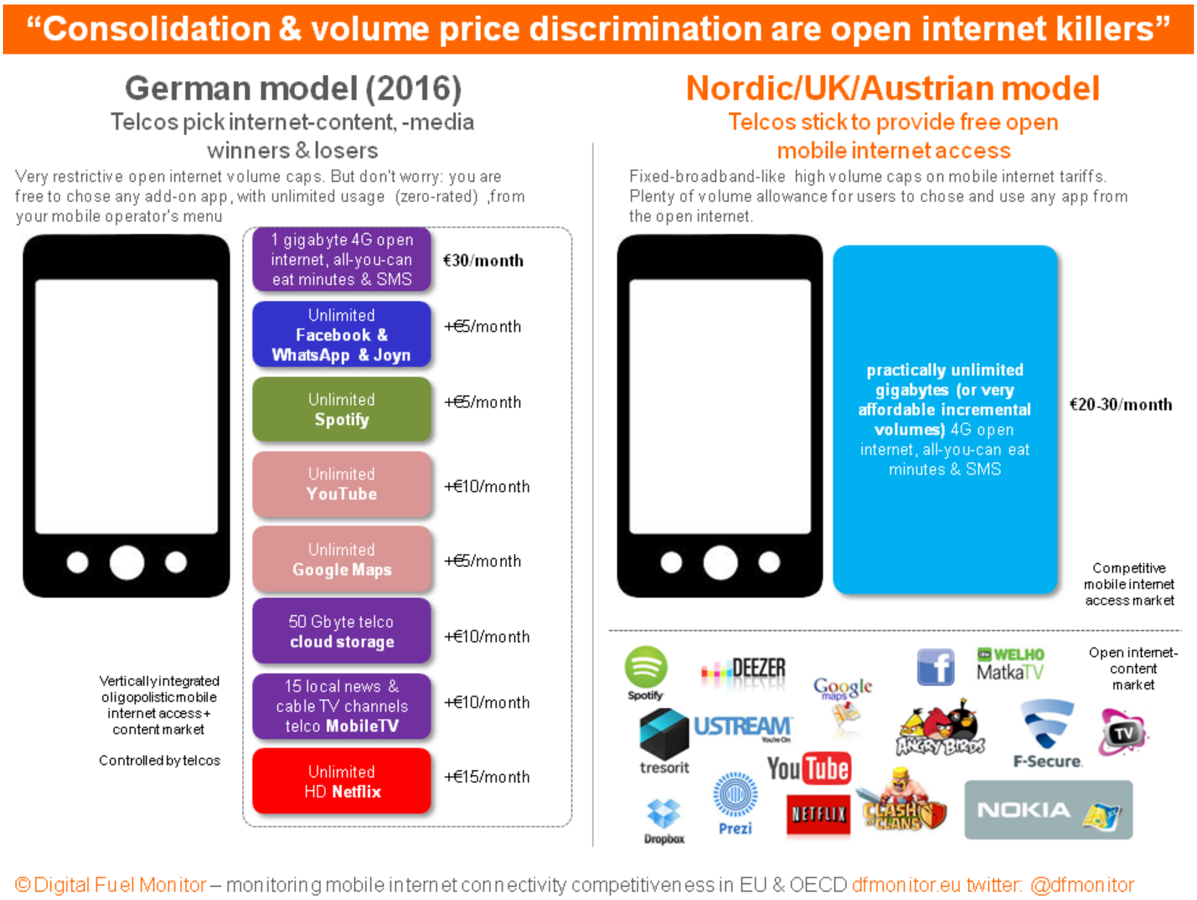
For speed capped fixed broadband internet access 'fast lanes' are application based differential speed caps. This discriminatory practice violates net neutrality and it is potentially anti-competitive. Similarly, for volume capped mobile broadband internet access 'zero-rated lanes" are application based differential volume caps. Likewise, application based differential volume caps are discriminatory and potentially anti-competitive.

Zero-rating the volume of selected bandwidth intensive apps (that is: giving these apps special unlimited volume caps) is a blunt potentially anti-competitive price discrimination.

Deutsche Telecom in Germany, E-Plus in Germany, Orange in France and many other European telco incumbents are zero-rating their own or their OTT partner's apps in 9 European mobile markets http://www.dfmonitor.eu/insights/2014_apr_premium_zerorate/

As illustrated in Exhibit 1 below the combination of heavily restricted open mobile internet volume caps and differential volume caps (in case of zero-rating: unlimited) for the telco's own and it's partner apps is a powerful tool for introducing the a la carte internet menu model. In the a la carte internet menu model consumers are deprived of choice. Unable to afford the upgrade to a higher volume cap plan or the data overage charges for using volume intensive open internet apps consumers are forced to resort to the zero-rated telco or telco partner apps.

Exhibit 1: Picking internet winners and losers in mobile internet with differential (zero-rated) volume caps



Source: Rewheel/Digital Fuel Monitor analysis

The background and the aftermath of the dodgy approval of Orange's Austria acquisition by Hutchison

The Commission wrote when it conditionally approved Orange Austria acquisition by Hutchison "*The Commission had concerns that the elimination of one out of only four mobile network operators in Austria could have led to less competition and higher prices, to the detriment of end consumers...To remove the Commission's concerns, H3G submitted a package of commitments... In light of these commitments, the Commission concluded that the transaction would no longer raise competition concerns*". So how did the Commission come to this conclusion?

- The Commission first concluded that Hutchison's initial commitments (MVNO access) "*were not suitable to eliminate the competition concerns that the Proposed Transaction would lead to a significant impediment to effective competition*". The Commission explained "*only accepts commitments... that eliminate the competition concerns entirely and have to be comprehensive and effective from all points of view.*"
- Then it conditionally approved the merger by accepting Hutchison's revised commitments (spectrum divesture and MVNO access with UPC being the first to sign). The Commission wrote "*that the Final Commitments are appropriate to eliminate the non-coordinated effects identified and, moreover, the possible coordinated effects.*"
- When asked by the Austrian Competition authority what happens if no new MNO enters it wrote "*the entry of MVNOs and possibly an MNO will guard against any possible coordinated effects*". So never mind about that.

The after math; a) No MNO entered the market b) 1.5 years later neither UPC nor any other MVNO entered the market using Hutchison's network c) Prices are keep going up. All three MNOs including Hutchison have hiked prices several times.

The Commission approved the concentration in Austria by accepting phantom ineffective remedies (4th entrant and MVNOs)

Is anybody in DG Competition being held accountable for this failure to enforce EU competition law?

Telefonica's revised Mickey Mouse commitments are irrelevant and ineffective

First things first! Before we put to the test the Telefonica revised commitments lets remind to all why the proposed acquisition of E-Plus by Telefonica will lead to a significant impediment of effective competition.

As established by the Commission in their Statement of Objections **competition will be impeded because of the elimination of one of the four national mobile network operators which is currently the most competitive force in the market.** Not because the German mobile market lack MVNOs or because the other MNOs or MVNOs lack access to Telefonica's WiFi network. So are Telefonica's revised commitments relevant and effective?

Structural remedy commitments; Telefonica has offered to lease to a potential new 4th MNO 40 MHz of high-frequency (2600 MHz) spectrum. In addition Telefonica offered to the potential new entrant access to its 5,000 WiFi urban network hot-spots and a national roaming agreement on commercial terms capped at 20% of its network. I beg your pardon?

So Telefonica is suggesting that a capital-light new entrant that leases, NOT ACQUIRES, the least favourable chunk of spectrum (2600MHz,) get access to its urban WiFi network and relies on its dictated commercial national roaming terms for covering the rest of the country will be substituting the competitive pressure exerted by E-Plus which is a fully fledged national coverage MNO that holds vital low frequency 900MHz spectrum and substantial high frequency (1800 & 2100 MHz) positions.

Telefonica is making a mockery of European competition law, merger regulations and DG Competition officials.

Such package could only create a phoney new 4th entrant. By no means could it lead to a new credible, independent 4th challenger MNO. It could only appeal to a "friendly" cable operator that is already present in Germany e.g. UPC. If UPC is indeed the intended beneficiary the match could be just perfect. UPC would get "friendly" mobile access to increase the attractiveness of their quad-play offering and who knows six months down the road Telefonica could strike a deal with UPC so they could also join the quad-play exclusive club. So as we predicted in our November 2013 report three fixed & mobile operators Deutsche Telekom, Vodafone-Kable Deutschland and Telefonica-UPC (Unitymedia KabelBW) could seal the broadband market in Germany. The future of open mobile internet access in Germany would be doomed. Like in Austria UPC would be the Trojan horse that fools the Commission to open its gate.

MVNO wholesale access commitment; Telefonica has offered an initial maximum peak capacity of 2 gigabytes per second – about a tenth of Telefónica's current peak usage which would double in three years. This peak capacity would be shared by up to three MVNOs. We ask three simple questions.

- **Why cap the capacity that MVNOs could use on Telefonica's network?** By capping the MVNO capacity Telefonica is effectively capping their market share or in other words is restricting the retail independence. If the MVNO retail offers are proven to be more competitive or more successful than Telefonica's then they should have the freedom to increase their market share without any limits or artificial network bottlenecks.
- **Why Telefonica's current peak usage is a relevant metric?** As we explained above and shown in Digital Fuel Monitor Telefonica o2 DE and the other three German mobile operators are suppressing demand by collectively overpricing open mobile internet access. So by allocating a portion of the current peak usage Telefonica is attempting to tame the MVNOs retail pricing potency in the market. MVNOs would only able to offer allowances to their retail customers similar with those that Telefonica offers to its own customers.
- **If regulated wholesale access MVNOs could substitute the competitive force exerted by the no.4 MNO why stop there? Why not substitute the no.3 MNO?** So one year down the road Telefonica and Vodafone could get merger clearance and create a duopoly by simply committing to give regulated wholesale access to MVNOs. There you go, magic.

Unfortunately magic and competition law are incompatible. Competition is more like pregnancy; you can't be half pregnant.

What are the effective commitments that may lead to a credible 4th entrant and may remedy the competition impediment? Lessons learned from Comcast's acquisition of NBC Universal in the US

- **Non-discrimination open mobile internet access commitment;** Comcast acquisition of NBC Universal in the United States was approved in 2011 on the condition that the merged company adhere to the principles of net neutrality and does not discriminate applications or services over its broadband networks. Similarly, **Telefonica shall offer not to discriminate in any way (speed, priority, QoS, volume(!), etc.) application or services over its network**. It shall commit to use most of its licensed spectrum capacity to offer open mobile internet access and it shall not reserve a significant share of such capacity for its own or its partner's OTT applications and services. Telefonica shall commit not to exempt, discount, sponsor, rebate or zero-rate retail the volume from the end-users allowance that its own or its OTT partner's applications generate and thus place all 3rd party apps at a competitive disadvantage.
- **Spectrum dispossession;** Telefonica shall offer to hand over (irrevocably cede title and all rights) to the German Federal Network Agency (Bundesnetzagentur) 2x5 MHz of the 900MHz and 2x17.4 MHz of the 1800MHz paired spectrum that E-Plus holds and is set to expire at the end of 2016. Furthermore, Telefonica shall hand over to Bundesnetzagentur minimum 2x10MHz of 2100MHz and 2x20MHz of 2600 MHz paired spectrum. Bundesnetzagentur shall reserve the Telefonica dispossessed spectrum for a new 4th entrant during an auction at a reserve price that does not impede the viability of the new 4th entrant business case. Bundesnetzagentur shall auction the 1800MHz spectrum in one package (2x17.4 MHz) and allow the successful bidder of the 1800 MHz package the option/discretion to purchase the 2x5MHz 900 and possibly other high frequency spectrum that has been set aside.
- **Customer divesture;** Telefonica shall offer to divest E-Plus' BASE post paid customers to the new 4th entrant at a price that does not impede the viability of the new 4th entrant business case.
- **Commitment to remain fully independent and not integrate in any way commercially or operationally with the new 4th entrant;** Telefonica shall commit for a period of 7 years to remain fully independent and not integrate in any way commercially or operationally with the new 4th entrant. It shall not acquire, merge, take a minority stake, enter into active network sharing agreements or spectrum pooling agreements or enter into commercial reselling or wholesaling agreements (e.g. Telefonica gains access to the 4th entrant pay TV, fixed broadband offering and bundles it with its mobile services see Telefonica/Yoigo in Spain).
- **Spectrum USE-IT-OR-LOSE-IT commitment;** Telefonica shall commit for a period of 7 years to meet minimum spectrum use targets (e.g. Megabyte/month/capita/MHz). The committed minimum spectrum utilization thresholds 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.
- **National roaming commitment;** Telefonica shall offer to the new 4th entrant at financial, technical and operational terms that do not impede the viability of the new 4th entrant business case a national roaming agreement for a period of up to 7 years. Each party should bear its network implementation costs which shall be reasonable. The 4th entrant shall lose access to the national roaming agreement if it fails to materially meet its spectrum license coverage obligations.
- **Site collocation commitment;** Telefonica shall offer site collocation to the new 4th entrant in all of its sites wherever technically feasible and subject to the underlying terms of the relevant site leases on standard commercial market terms.
- **Site divesture;** Telefonica shall offer to the new 4th entrant on standard commercial market terms all sites (not as package) which, following the acquisition of E-Plus, are not required and are schedule to be decommissioned.
- **Backhaul access commitment;** Telefonica shall offer to the new 4th entrant access to its high capacity backhaul networks (fibre, MW, etc.) on standard commercial market terms
- **MVNO wholesale access commitment;** Telefonica shall offer net neutral wholesale access to MVNOs. There should be no limit, restriction or cap in the network capacity that a single MVNO customer or all customers of one MVNO or in the total capacity allocated to MVNOs in Telefonica's network. The wholesale access terms i.e. price of access, etc. for MVNOs shall follow the principals of LLU cost oriented unbundling.

What happens if no credible new entrant shows up to acquire the spectrum and Telefonica's non-structural commitments (e.g. MVNOs) do not remedy in full the impediment of effective competition?

- Any market structure with 3 network operators with or without regulated MVNO access will intrinsically yield less competition from a market structure with 4 network operators, presuming efficiencies are not proven.
- If the current market structure supports profitably 4 network operators (i.e. no "failing firm" defence can be argued) why will the Commission grant approval to a concentration that is certain to lead to a significant impediment of effective competition?
- The only remedy that has the potential to eliminate the competition concerns entirely and could be effective from all points of view, as the law requires, is the actual market entry of a new credible independent 4th challenger MNO. **Therefore the approval of the merger should be conditioned on the actual market entry of a new 4th challenger MNO**. If no credible (MNO that acquires not leases 1800 and/or sub 1GHz spectrum) MNO 4th entry materializes the Commission must enforce the law and block the merger.
- And what is the view of the General Court? The General court wrote went it upheld the Commission's decision to prohibit the Ryanair/Aer Lingus merger "*the mere threat of an entry (...) is not sufficient. (...). What counts is the prospect of an entrant which offsets the anti-competitive effects specifically established in the contested decision (...). (14)*".