

## T-Mobile Austria/tele.ring: Remediating the loss of a maverick <sup>(1)</sup>

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On 26 April 2006, the Commission authorised the acquisition of sole control by T-Mobile, a subsidiary of Deutsche Telekom, of the Austrian mobile phone operator tele.ring, leading to a combination of two Austrian mobile network providers. The Commission reached this decision after an in-depth investigation, including a Statement of Objections, on the basis of the commitments submitted by the notifying party. The decision is relevant in particular for two aspects: First, for the application of the new test, introduced by the recast Merger Regulation <sup>(2)</sup>, to an undertaking which would not become the market leader after the transaction and, second, for the remedies accepted by the Commission.

### 1. Relevant market

Both T-Mobile and tele.ring have operated mobile telephony networks in Austria and have been active on the respective retail and wholesale markets. The merger caused specific problems only in the Austrian retail market for the provision of mobile telephony services to end customers. The discussion in this article will focus on this market.

The Commission did not further delineate the retail market between business and residential or post-paid and pre-paid customers, mainly for reason of supply-side substitutability. The Commission also concluded that there is a single product market for 2G and 3G mobile telephony services for the basic services (such as voice telephony and basic data services) which can be provided on both technologies. However, the Commission left open whether there was a distinct market for additional services, such as value-added and multimedia services, which can only be provided on 3G networks, as the concentration did not raise any competition concerns in this respect.

### 2. Market Structure

Before the transaction, on the Austrian retail market for mobile telephony services, four undertakings have operated 2G (GSM) mobile telephone networks with an Austrian-wide coverage: Mobilkom

(a subsidiary of Telekom Austria), T-Mobile, ONE and tele.ring. Each of them has also operated a 3G network in parallel.

In addition to these four established operators, H3G (a subsidiary of Hutchison) entered the market in 2003 and provides mobile telephony services purely on the basis of a 3G network. However, this network covered only 50% of the Austrian population at the end of 2005 (this was also the regulatory minimum requirement for the coverage at this date) and less than 10% of Austria in geographic terms. In order to be able to offer its customers mobile telephony services throughout Austria, H3G has entered into a national roaming agreement with Mobilkom for the areas not covered by H3G's own network.

The market shares of the operators developed as follows in recent years on the basis of the number of customers <sup>(3)</sup>:

Operator	First half 2005	2004	2003	2002
Mobilkom	[35-45] %	[35-45]*%	[40-50]*%	[40-50]*%
T-Mobile	[20-30] %	[20-30]*%	[20-30]*%	[25-35]*%
tele.ring	[10-20] %	[10-20]*%	[5-15]*%	[<5]*%
<b>T-Mobile/ tele.ring combined</b>	[30-40]%	[30-40]*%	[30-40]*%	[30-40]*%
ONE	[15-25]%	[15-25]*%	[15-25]*%	[15-25]*%
H3G	[<5]*%	[<5]*%	[<5]*%	0%

The Commission further analysed the position of service providers. Their role is quite limited in the Austrian market, with an aggregate market share of around 5%. The most relevant service provider is YESSS!, the discount brand of the network operator ONE, which entered the market in April 2005. It only has a pre-paid offer, is distributed via a grocery discounter and the Internet, and its services are limited to voice telephony (including a voice mailbox) and SMS. No other services, such as other data services or international roaming, are offered.

<sup>(1)</sup> The content of this article does not necessarily reflect the official position of the European Communities. Responsibility for the information and views expressed lies entirely with the authors.

<sup>(2)</sup> Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ L 24, 29.1.2004, p. 1.

<sup>(3)</sup> The development of the market shares on the basis of turnover generated by the operators and on the basis of originating minutes was similar to the shares on the basis of customers.

### 3. Non-coordinated effects

For the competitive assessment, the Commission focused on the analysis of non-coordinated effects. It concluded that, despite the fact that T-Mobile would not be the biggest operator in terms of market shares after the operation, the elimination of tele.ring as independent operator would lead to non-coordinated effects and to a significant effect on prices. The Commission could leave open whether the concentration would in addition lead to coordinated effects as the commitments proposed by the notifying party would also rule out any coordinated effects the transaction might create.

#### *Analysis of tele.ring's past competitive behaviour*

Concerning tele.ring's past competitive impact in the market, the Commission based its analysis on three elements: (1) market shares, (2) switching rates and (3) pricing behaviour.

The starting point for the Commission's analysis was the development of the market shares from 2002 to mid-2005. On the basis of customers, tele.ring's market shares more than doubled in this period whereas T-Mobile's and Mobilkom's shares decreased significantly and ONE's market share remained stable. The new entrant H3G significantly increased its market shares since 2003, but was still below 5% in 2005. The Commission concluded that the development of the market shares indicated that tele.ring played a very active role in the last years whereas Mobilkom, T-Mobile and ONE remained rather passive.

Due to the steep increase of tele.ring's market shares, already the market share data suggests that a large proportion of customers who left T-Mobile and Mobilkom have become tele.ring's customers. The data collected by the Austrian regulator for those customers that switched provider by using number portability supports this interpretation. In 2005, more than half of those switching customers went to tele.ring and roughly 60% of those customers which left T-Mobile and Mobilkom, respectively, switched to tele.ring. Second behind tele.ring was H3G, which picked up some 20% of all customers that switched provider by porting their numbers. Even though those customers do not account for all customers who changed provider, this analysis clearly indicates that tele.ring exerted the strongest competitive pressure in the market, in particular on Mobilkom and T-Mobile.

The Commission also analysed average per-minute prices on the basis of all tariffs applied by the various network operators, using data provided by the Austrian telecom regulator for 2001-2005. The

data shows that, overall, prices constantly fell in this period and that tele.ring has offered its services since the third quarter of 2002 at significantly lower prices per minute than the other three 2G network operators, Mobilkom, T-Mobile and ONE, the prices of which were in the same range. H3G's average per-minute prices were quite close to those charged by tele.ring, without undercutting them.

This price analysis was confirmed by a comparison with the results obtained from the tariff calculator of the Austrian Chamber of Labour ('AK Wien'). Based on the tariff situation of October 2005, the simulation used profiles of typical mobile communications users with monthly call volumes from 30 to 480 minutes and the average user profiles of T-Mobile and tele.ring. In these simulations, tele.ring was the cheapest supplier in the majority of cases and H3G was the cheapest provider in most of the other cases (and the second cheapest provider when tele.ring had the lowest price). In addition, the Commission made a long-term price analysis by looking at the monthly tariff comparisons for all providers published by AK Wien from 2003 to the first half of 2005. The analysis showed that tele.ring was the provider offering the cheapest tariff most frequently, followed by H3G, whereas T-Mobile, Mobilkom and ONE offered the lowest prices in considerably fewer cases. Of particular significance is the analysis of post-paid subscribers, who account for the overwhelming majority of tele.ring's customers. Among this customer group, tele.ring was the cheapest supplier in considerably more than 50% of cases, whereas H3G was the cheapest provider in the remaining cases; T-Mobile, Mobilkom and ONE did not offer the lowest prices in a single case.

From the analysis of tele.ring's past competitive behaviour, the Commission concluded that, during the period 2002 to 2005, tele.ring was the most active player in the market, exerted considerable competitive pressure in particular on T-Mobile and Mobilkom and played a crucial role in restricting their pricing behaviour. The analysis therefore suggested that tele.ring performed the role of a maverick in the market.

#### *Incentives and Network Costs*

The Commission further analysed the incentives of mobile telephony operators to price aggressively, in particular in order to attract new customers. The costs of the mobile industry are determined by high investment costs for the construction of a network with a country-wide coverage, network operation costs that are to a large extent independent of its actual use, and relatively smaller variable costs.

Due to the high proportion of fixed costs, network operators generally have the incentive to use the capacity of the network as fully as possible via a large customer base. This is in particular true for small network operators that first have to build up their customer base to be able to recoup the investments and cover the network operating costs. However, the incentives for attracting new customers change with a larger customer base. Attracting new customers by adopting an aggressive pricing policy will reduce the profitability of the existing customer base, as the favourable conditions will have to be extended to the existing customers at least in the medium-term. Therefore, the larger the customer base, the less likely is an aggressive pricing strategy aimed at attracting new customers, as the reduced revenues from the existing customer base can no longer be offset by the additional income to be expected from new customers. In the past, tele.ring and H3G therefore had the incentives to adopt an aggressive pricing policy, as the new customers always more than offset any price cuts offered to existing customers. By contrast, neither Mobilkom nor T-Mobile had caused any shift in market prices in the past by making particularly aggressive offers, which can be explained by their large base of existing customers, as reflected in their market share. The Commission also analysed the composition of the customer base in terms of phone usage and calling patterns to understand the brand positioning and pricing behaviour of the different operators. The Commission considered that the merger would increase T-Mobile's number of customers further and thereby strengthen its incentive to focus on the profitability of its existing customers instead of aiming at attracting new customers.

### *Role of the other operators after the transaction*

The Commission further concluded that, after the transaction, no other operator could take over the role that tele.ring had played in the past.

For H3G, the Commission acknowledged that it followed a strategy of aggressive pricing in the past, but considered that it could not be regarded as a fully-fledged competitor due to the lack of full network coverage and only limited frequencies. The dependence on the national roaming agreement with Mobilkom considerably increases H3G's variable costs and restricts its scope for an aggressive pricing strategy. It entails substantial variable costs for H3G per minute with a direct impact on the prices charged to the final consumer and leads to incentives which are quite different from network operators when it comes to adopting an aggressive pricing strategy and attracting new customers.

The Commission considered it further likely that H3G would extend its network, but concluded that there would be significant uncertainties for the build-up of a network with a full coverage in the foreseeable future, given the increasing difficulties to find locations for additional mobile telephony sites in Austria due to heightened environmental concerns and planning requirements. In addition, H3G's limited frequency spectrum (compared to its competitors) severely limits its capacity. The Commission therefore concluded that H3G would not have the ability to act in the future as a constraining force for the other mobile operators in a similar way as tele.ring in the past.

The Commission also discarded ONE and its discount brand YESSS!, as operator which could form a similar competitive constraint on T-Mobile and Mobilkom as tele.ring. In the past, ONE had not acted as price-aggressive operator, but positioned itself as an operator with a specific focus on network quality. The Commission considered it very unlikely that ONE would find it profitable to adopt a similar strategy as tele.ring and did not find any indications that ONE would change its strategy. For the discount brand YESSS!, the Commission concluded that due to its very limited services and its focus on pre-paid customers YESSS! could not be considered to be a competitive constraint similar to tele.ring and would not be an alternative for customers of tele.ring with its very high share of post-paid customers. In any case, YESSS! only entered the market in April 2005 and fully depends on its parent company ONE for its pricing behaviour. The Commission considered it doubtful whether ONE would continue to follow the discount strategy once tele.ring had disappeared, in particular as ONE would no longer have to compensate to the same extent for the loss of customers of its quality brand ONE.

### *Future competitive behaviour of tele.ring*

The Commission also analysed whether tele.ring would likely continue its past competitive behaviour in the future. The Commission, *inter alia*, analysed tele.ring's pre-merger business plan which showed that it aimed at growth rates far exceeding the general market growth also in the future. Therefore, it seemed likely that tele.ring would continue its aggressive pricing strategy to achieve this growth by attracting customers from other operators.

### *Conclusion for non-coordinated effects*

The Commission concluded that, due to the elimination of the maverick in the market, it would be likely that the transaction would produce non-coordinated effects and significantly impede effec-

tive competition in a substantial part of the common market. For this conclusion, the Commission referred to the Horizontal Guidelines which state that some firms have more of an influence on the competitive process than their market shares would suggest. A merger involving such a firm could change the competitive dynamics in a significant anti-competitive way, in particular when the market is already concentrated<sup>(4)</sup>. The present case shows that the finding of non-coordinated effects is not limited to the mostly quoted scenario for these effects, i.e. a situation where the merging parties are the closest competitors to each other.

#### 4. Commitments

For being able to accept commitments, the Commission had to be convinced that the remedies would create a player which would likely play a similar role in the market as played by tele.ring in the past and would act as a similar competitive constraint on the other mobile telephony providers, in particular Mobilkom and T-Mobile.

The remedies submitted by T-Mobile contain two main elements. First, T-Mobile committed to divest tele.ring's two packages of UMTS-frequencies, one to H3G and the other one to a competitor with a smaller market share. Second, T-Mobile committed to divest a very large number of the mobile telephony sites currently operated by tele.ring (including all necessary technical equipment), mainly to H3G, some to ONE (if interested). In order to achieve an up-front implementation of the commitments as far as possible, T-Mobile entered into a legally binding framework agreement with H3G for the divestiture of UMTS-frequencies and a large number of mobile telephony sites already during the procedure. Only this up-front implementation of the commitments gave the Commission the necessary certainty that H3G would purchase sites and frequencies and that the competition concerns were likely removed.

In a nutshell, the commitments will enable H3G to acquire the essential parts of tele.ring's network infrastructure so that H3G will be able to build up a country-wide network and to quickly become a full network operator. According to H3G's business plan, the acquisition of the tele.ring sites will allow H3G to achieve complete network coverage of the population in the near future. The divestiture of at least one UMTS-frequency package to H3G will further enlarge its capacity and enable

H3G, in particular, to reserve one 5 MHz UMTS frequency block for voice telephony. The additional frequency package will therefore increase H3G's overall network capacity, allowing it to serve a larger number of customers on its own network and giving it a stronger incentive to attract a large number of new customers.

The Commission assessed the likely effects of the commitments on H3G's role in the market, in particular on its incentive to price aggressively in the field of voice telephony. Building its own network will eliminate H3G's dependence on the national roaming agreement with Mobilkom, reduce its variable per minute costs considerably and allow H3G to achieve much larger economies of scale. H3G already in the past offered the most attractive prices after tele.ring. Due to its currently small customer base, H3G has strong incentives to exploit the economies of scale of an own network and to attract a large number of new customers by an aggressive pricing policy in order to 'fill' this network. This is supported by its revised business plan which takes account of the acquisition of the mobile telephony sites and the UMTS-frequencies. Therefore, H3G could be considered to be in a comparable role as tele.ring in the past and it is likely that H3G will act as a competitive constraint on the other operators in a similar way as tele.ring did.

The incentives to offer attractive prices in voice telephony are not substantially changed by the fact that H3G is an operator of a 3G network whereas tele.ring was mainly a 2G operator. While H3G offers also other services in addition to voice telephony, the Commission concluded that voice telephony services will, in the foreseeable future, still play the most important role also for 3G operators in terms of capacity used, revenues and profits. The Commission considered in addition that attractive prices for voice telephony, as the basic service, will also for H3G be the most relevant factor for attracting a large number of new customers to whom also multimedia services may be sold.

The conclusion that H3G would be suitable to play a similar role in the market as tele.ring was further supported by the similar 'communication profile' of their customers. Customers of both operators are price sensitive and the share of post-paid and frequent users of mobile phones is considerably above average for both. The fact that, in 2005, nearly half of the customers who switched away from tele.ring by porting their numbers went to H3G shows that H3G is the next best alternative for tele.ring customers.

Due to the similar incentives of H3G and tele.ring with regard to winning new customers and, in

<sup>(4)</sup> Commission's Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C 31, 5.2.2004, paragraph 37.

addition, a comparable communication profile of the customers of both operators, the Commission concluded that there would be strong indications that H3G would follow a similar price strategy in the future as tele.ring has done in the past and

that the commitments would eliminate the risk of a significant impediment of effective competition on the retail market for mobile telephony services in Austria as regards non-coordinated as well as possible coordinated effects.