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Magic Numbers and Merger Control in the Telecommunications Sector

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I. ON NUMBERS AND MERGER CONTROL

"There is no magic number,"[2] stated the European Commissioner Margrethe Vestager in early October of this year. The statement followed the withdrawal of the merger planned by Telenor and TeliaSonera, after the European Commission ("EC") objected, which would have merged the second and third largest Danish mobile operators and reduced the number of mobile network operators ("MNOs") to three. It was also a response to the calls for consolidation in the mobile telecom sector and the argument that markets with four mobile operators could not keep up with investments. While four is a must for some regulators,[3] "three is the magic number," according to the industry.[4]

A few years ago, the number "three" seemed to have magical powers, this time for the Swiss Competition Commission who blocked the merger between the second and the third largest mobile operators in 2010,[5] which would have created a MNO duopoly. Switzerland does not have the luxury of having four mobile network operators;[6] the same investment imperative was raised by telecom companies to justify a sustainable telecom market with only two players. This shows that after ongoing consolidation toward three MNOs, the industry would put forward the same arguments for a sustainable "magical duopoly" case in Europe.

Competition is not about numbers, but rather it is about effective competition at the retail level. Yet, numbers count for the assessment of anticompetitive effects and remedies, since merger control focuses on structure, the loss of competition prevailing before the merger, and replacement of that loss. When one competitor disappears, the remedies somehow have to replace its impact. Even the absorption of the smallest competitor may change market equilibrium, since such small

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[2] "Competition in telecom markets," speech held on 2 October 2015, at the 42nd Annual Conference on International Antitrust Law and Policy, Fordham University, available at http://ec.europa.eu/commission/2014-2019/vestager/announcements/competition-telecom-markets_en.

[3] *Four is a Magic Number*, THE ECONOMIST, (March 15, 2014), *available at* http://www.economist.com/news/business/21599012-operators-both-sides-atlantic-hope-break-spell-four-magic-number?fsrc=email_to_a_friend.

[4] *Together We Stand*, THE ECONOMIST, (August 22, 2015), *available at* http://www.economist.com/news/business/21661660-eus-new-competition-chief-will-have-rule-wave-mergers-together-we-stand.

[5] Swiss Competition Commission, decision of 19 April 2010, France Télécom SA/Sunrise Communications AG, DPC 2010/3, p. 499.

[6] Tele2, the smallest MNO, was acquired in 2008 by Sunrise, the third largest MNO. The Swiss Competition Commission cleared the merger without opening an in-depth investigation (DPC 2008/4, Sunrise/Tele2, p. 668).

players are often those that compete aggressively on the market to gain scale (the "mavericks") and disrupt coordination.[7]

But numbers are not the only factor taken into account; each merger assessment is case-specific, meaning specific to the conditions prevailing in the national market. Competition authorities have to deal not only with increased concentration and the risk of coordination, but also with the consequences of the integration of broadband and fixed telephony as well as bundling of services (triple or quadruple offers).

The assessment of telecom mergers follows a classical analysis of the merger's impact on market shares and market concentration, and on the loss of competition compared to the situation before the merger, and, therefore, the ability of the new entity to raise prices or lower output and quality. Cost savings and investments play a role in the assessment of ability of efficiency gains to offset the loss of competition.

Recent Telecom Merger Cases:

Year	**Merger**	**Concentration**	**Position of merging parties before merger**	**Clearance and Remedies**
April 2010	Orange/Sunrise (Switzerland)	3 to 2 merger in the MNOs market	2nd and 3rd	Prohibition
December 2012	Hutchison 3G Austria/Orange Austria (M.6497)	4 to 3 merger in the MNOs market	3rd and 4th	One upfront MVNO agreement, wholesale MNVO access agreements for up to 30 percent of its network capacity, spectrum divestiture, national roaming, and preferential rights to sites
July 2014	Telefonica Deutschland/E-Plus (M.7018)	4 to 3 merger in the MNOs market	3rd and 4th	Lease of spectrum, national roaming, divestment of building sites and shops (NMO Remedy); up to three upfront mobile bitstream access agreements for 30% of its capacity (MBA Remedy); wholesale access agreement to 2G/3G and 4G networks (non-MNO Remedy)
May 2014	Hutchison 3G UK/Telefonica Ireland (M.6992)	4 to 3 merger in the MNOs market	2nd and 4th	One upfront MVNO agreement, spectrum divestment, improvement of existing network sharing agreements
May 2015	Jazztel/Orange (M. 7421)	4 to 3 merger in the fixed telecommunica tion market	3rd and 4th	Divestment of FTTH network, wholesale access to ADSL bitstream service

[7] One of the first cases in mobile telecommunications was dealt with in the EC decision of 11 November 2000, M.2016, France Télécom/Orange (mobile telecommunication market in Belgium).

September 2015	Telenor/TeliaSonera (M.7419)	4 to 3 merger in the MNOs market	2nd and 3rd	Withdrawal / abortion[8]
Ongoing	Hutchison UK/Telefonica UK (O2) (M.7612)	4 to 3 in the MNOs market	2nd and 4th	In-depth investigation by the EC,[9] CMA (UK) asked referral
October 2015	BT Group (Vodafone UK)/EE (UK)	4 to 3 in the MNOs market	1st and 3rd	Provisional clearance by the CMA (UK); final decision expected by January 2016
Ongoing	Liberty Global/BASE Belgium (M.7637)	No change in the MNO market	3rd MNO and the largest MVNO	In-depth investigation by the EC[10]

II. INVESTMENTS AND COST SAVINGS

One of the underlying premises of competition law states that **competition drives investment**. This basic premise is challenged by telecom operators, who allege that without merging, some of them would not be able to undertake the necessary investments. But how is this linked with numbers and cost savings? In order to recoup investments, operators have to increase their customer base and, therefore, scale. Increasing scale via mergers and eliminating duplication of networks allow them to achieve fixed-cost savings. Scale and investment create barriers to entry, which protect existing MNOs from potential competition.

Along with frequency scarcity, this argument explains the "natural" concentration in the mobile communication market. This is understood from a competition policy standpoint, as is also the fact that barriers to entry and existing concentration are sufficient to protect current operators' business and allow them to invest. Other sectors do not benefit from such protection. At this point, it is not clear how higher concentration correlates to (more) investment, since reducing the numbers from four to three would not necessarily increase investment, but would very likely increase wholesale and retail prices. This possibility of increased prices explains the EC's doubts on the rationale of consolidation, saying higher concentration is driven by the expectation of higher revenues[11] rather than the need for cost savings. In the end, competition policy is not the right tool to handle investment incentives; challenges to introduction of new technologies should be considered in sector specific legislation applicable to the industry, not in individual merger control decisions.

Retail competition is important. It is that competition that keeps prices down for consumers, particularly when concentration or cooperation reduces it at the infrastructure level. While telecom operators allege that scale allows them to invest and realize cost savings, the

[8] Statement by Commissioner Vestager on announcement by Telenor and TeliaSonera to withdraw from proposed merger, EC press release of 11 September 2015.

[9] Commission opens in-depth investigation into Hutchison's proposed acquisition of Telefónica UK, EC press release of 30 October 2015.

[10] Commission opens in-depth investigation into proposed acquisition of BASE Belgium by Liberty Global, EC press release of 5 October 2015.

[11] *See* EC decision of 2 July 2014, Telefonica Deutschland / E-Plus, M.7018, ¶ 541.

competition authorities assess first whether these cost savings will reach consumers[12] or whether they would be "passed-on" and, second, whether there are other ways to achieve the same goal without increasing further market concentration.

Cost efficiencies can be achieved without consolidation. Competition authorities claim that such efficiencies can be achieved through network-sharing agreements, an alternative that allows cost efficiencies in infrastructure and investment, while preserving the same number of operators running their own network. The difference between network-sharing agreements and consolidation is that with network sharing, the number of MNOs is safeguarded as are the benefits of competition at the wholesale and retail levels. Mobile operators without networks ("MVNOs") and other service providers diversify the retail offer and put pressure at the retail prices.

III. REMEDIES AND COMPETITION AT THE RETAIL LEVEL

Market maturity and convergence is challenging growth in the mobile telecommunication market. Free voice telephony and text messages are challenging fixed and mobile operators' margins; these operators should, in turn, invest and price differently their broadband and 3G/4G connections. Increased concentration enables higher prices and improves operators' profitability.

The focus of competition policy is on consumers and, therefore, retail pricing. The majority of remedies aim at lowering barriers to entry to newcomers, MNOs, and MVNOs, in order to maintain the same level of competition pressure at the wholesale and retail level. Spectrum divestment, upfront sale of capacity to MVNOs, and wholesale access guaranties are designed to enable existing or new mobile operators to increase their offers at the retail level without having to invest in a network.

Safeguarding competition between MNOs has an impact on the basic costs of MVNOs and their negotiation power in a regulatory setting, which generally does not grant mandatory access to the networks of MNOs. Access remedies ensuring MVNOs or other service providers access to the networks of MNOs are highly regulatory in nature, and create inequality between MNOs. The new entity has to respect its commitments, which is not the case for other operators. On the other hand, while they define access conditions to the network of the new entity, such remedies have no bearing on the market behavior of other MNOs, nor on the virtual network providers. Such remedies may be imperfect to correct market coordination.

Competition authorities have been reluctant to impose behavior or pricing remedies at the wholesale or retail level. The EC does not use price caps or price monitoring remedies. Although they might help control unilateral price increases by the merging parties, such caps cannot do much on the coordination effects due to price increases by other operators in the market.

Another issue is implementation of remedies. When network access and spectrum are not used by new competitors, remedies cannot function and significant competition is lost in the merger. This was apparently the case in Austria after the Hutchison 3G/Orange merger in 2012, where the remedies were not able to create a newcomer and replace the loss of competition.

[12] Cost efficiencies related to fixed infrastructure are not reflected in prices, and cannot be fully "passed-on" to consumers, contrary to efficiency gains in variable costs, according to the European Commission. This point is highly debated by telecommunication operators.

According to OECD, the clearance of the Hutschison acquisition of Orange Austria by the European Commission resulted in higher prices of about 10 percent for some offers.[13] OCDE states that "prior to the merger, Austria had one of the least expensive markets for mobile communication services in the OECD." This is no longer the case after the clearance of the merger by the EC, contrary to the view of the Austrian competition authority. The Austrian precedent may impact future cases.

The particularities of national markets call for more involvement of national competition authorities, and highlight the limits of the one-stop-shop merger control in Europe. Referrals to national competition authorities might allow them to design better remedies and, if necessary, introduce price caps or price monitoring mechanisms, if such authorities can supervise these measures. If not, prohibition might be the only remedy.

Mergers have lasting impact on market structure. The regulatory remedies which have been used in recent times might be highly regulatory and difficult to enforce, and are not effective tools to control price increase. Investment imperatives cannot be addressed by merger control. These difficulties explain the temptation of the EC and other competition authorities to go back to the source of merger control and preserve market structure by preserving numbers.

[13] OECD, *Wireless Market Structures and Network Sharing*, OECD Digital Economy Papers, No. 243 (2014), *available at* http://dx.doi.org/10.1787/5jxt46dzl9r2-en, at 31: "After the merger prices jumped from Q2 2012 to Q1 2013 with an 8 to 10 index points across the board, or a 12% increase for some offers."