

# CRA Competition Memo



## T-Mobile/tele.ring: analysing mavericks and efficiencies in “the first gap case”

The T-Mobile Austria/tele.ring transaction<sup>1</sup> involved the takeover of the number 4 in the Austrian mobile phone market (tele.ring) by the market’s number 2 (T-Mobile Austria). Although the merger increased T-Mobile Austria’s market share to about a third of the market, the company remained smaller than Mobilkom, the largest operator in the Austrian mobile telephony market. Hence, the merger would have been a difficult case to handle by the European Commission under the “old” EC Merger Regulation with its focus on either a single dominance or a collective dominance model, where the latter, at least after Airtours, was confined to coordinated effects concerns. Thus, the case was informally referred to as the “first gap case” analysed by the European Commission under the “new” EC Merger Regulation.<sup>2</sup>

The EC raised concerns that tele.ring may have had a particularly strong competitive impact on the Austrian market given its status as a low price provider and its continuously growing market share. Nonetheless, the Commission cleared the case after T-Mobile offered specific remedies designed to strengthen the market position of smaller players, including Hutchison 3G. In particular, T-Mobile Austria had to sell UMTS frequencies to Hutchison.

Although from the beginning the Commission investigated coordinated effects in parallel, the focus of the final decision was on unilateral effects. The case showed that arguing unilateral and coordinated effects in parallel requires careful consistency checks to avoid contradictions. This memo focuses on the assessment of unilateral effects.

### “Maverick” semantics

Despite its focus on unilateral effects, the European Commission referred to tele.ring as a “maverick” throughout the case. This is unconventional as the term “maverick” is usually used in the context of coordinated effects - and for a good reason. In order to sustain collusion, the coordinating parties need to deviate from the behaviour that would be optimal in the short-run, i.e. given the prices of the competitors it would be profitable to set the price below the collusive level. Mavericks are rivals that do not wish to be part of the coordinating group, due to their corporate culture or for other reasons. The existence of a maverick can render the ability of other firms to coordinate impossible. However, used in the context of unilateral effects the term “maverick” is misleading. Any unilateral effects analysis must model accurately any firm which adopts a business strategy of low-

cost/low-price. The word “maverick” adds nothing to the analysis.

Nevertheless, at first sight the European Commission had a unilateral effects case to investigate. Since its market entry in November 2001, tele.ring had increased its market share from 1% just after market entry to 12% at the end of 2005 (based on subscribers and considering network operators only). Switching data indicated interaction between tele.ring and T-Mobile and other firms. So the Commission feared that removing tele.ring from the Austrian market might significantly lower the competitive constraints on the remaining operators. However, as is argued in the following sections, assessing the unilateral effects of a merger merely based on these facts is misleading. Unilateral effects analysis is complex and requires careful assessment of product positioning and the competitive constraints that prevail after the merger. In the following we discuss a number of facts that matter in mobile telephony markets in general and in this case in particular. Besides the product positioning we focus on the availability of capacity, the role of resellers and efficiencies attributable to the merger.

### Product positioning and incentives

One key concern in unilateral effects cases is the incentive to raise prices post merger: price increases become more profitable because some of the volume that would have been lost to rivals before the merger is now kept within the merged firm. As this logic applies to both brands of the merged firms, prices are expected to increase. Another way of looking at the same effect is to note that any price reduction of the tele.ring brand after the merger will lead to cannibalisation, i.e. customers switching from T-Mobile to tele.ring. Indeed, one of the concerns raised by the Commission was that T-Mobile would “take tele.ring out of the market” in order to avoid cannibalisation.

Unilateral effects are strongest if the products of the merging firms are similarly positioned in the market and if the firms are close competitors. Moreover, the effects are stronger if there are no, or limited, alternative providers available in that segment and customers’ sensitivities to price low. Analysis of the product positioning and customer behaviour, however, showed that tele.ring customers were particularly price sensitive and that T-Mobile and tele.ring were positioned in different segments of the market, thus significantly reducing the incentive to raise prices post merger:

- While tele.ring is positioned in the low cost segment T-Mobile is perceived as a high quality brand. While tele.ring was successful in *developing the low cost segment* by offering customised low cost solutions it also *increased product differentiation* in the market, with T-Mobile and the incumbent operator Mobilkom being positioned at the higher

<sup>1</sup> COMP/M.3916: Charles River Associates provided economic advice to T-Mobile throughout the merger.

<sup>2</sup> See Charles River Associates competition memo on the Oracle/PeopleSoft case (December 2004) for a discussion of a “gap” case analysed under the old ECFR.

end of the market. Thus, despite *past* switching from the high quality providers, low cost operators like H3G and service providers like YESSS!!! (a subsidiary of the network operator ONE) are more important rivals for tele.ring today, after the creation of the low cost segment. In this situation cannibalisation effects post merger will be limited.

- The positioning of tele.ring in the low cost segment is underpinned by evidence showing the price sensitivity of tele.ring customers, with minutes of use per tele.ring customer responding strongly to price changes. This differentiation in market positioning between the merging parties significantly reduces the post-merger incentive for T-Mobile to raise prices or eliminate the tele.ring brand without moving tele.ring customers to similar T-Mobile tariffs.

Similarly, in the high quality and business customer segments T-Mobile is mainly constrained by other operators, in particular the incumbent Mobilkom.

### Capacity constraints

One critical element reducing the incentive to raise prices unilaterally is fear of customers switching to rivals. Thus, a necessary condition for rivals to be an effective competitive constraint is that they have sufficient capacity to take on T-Mobile/tele.ring customers in a hypothetical scenario where prices increase post merger. The European Commission raised concerns about capacity constraints in the case. It is difficult to follow this assessment. All players had sufficient frequency in order to expand the network and accommodate additional customers. Indeed, in none of the recent decisions in the telecoms segment were capacity constraints identified as an issue (e.g. KPN/Telfort (NL), Telefonica/O2 (Spain), France Telecom/Amena (France/Spain), Telia/Sonera (Sweden), Vodafone/Oskar (UK), TeliaSonera AB/Orange A/S (Denmark)).

With capacity increasing due to 3G roll-out in all mobile telephony markets, capacity constraints are even less likely to be an issue in future cases in this industry.

### Resellers

Any remaining concerns in relation to post-merger competition in the low-cost segment were further mitigated by the potential for resellers to enter and expand as competitors to network-based operators. Given enlarged capacity, there is an increasing incentive for network operators to open the network to resellers, which position themselves in segments of the market not fully covered by the network operator itself. In fact, Austria is just one of many examples where operators prefer a situation where they have a large volume of resellers' minutes on their network to a situation where these minutes are on the networks of the rival network operators. With increasing capacity this balance tilts more towards opening the network or to positioning service provider subsidiaries in the segments not covered by the own brand. These trends are likely to increase competition, particularly in the low cost segment.

But what about that incentive for network operators to keep resellers out altogether? In some countries competition authorities have been concerned about alleged coordinated efforts of mobile network operators to keep resellers out (see decisions in France, Ireland, and Spain). In Austria such concerns have less foundation as resellers already have access to the wholesale market. ONE has already responded with its own low cost service provider subsidiary YESSS!!!, which has shown strong growth rates. Thus, further growth in the low cost segment can be expected.

The UK is an example for the potential development in countries like Austria. There are 59 resellers (Mobile Virtual Network Operators (MVNOs) and pure service providers) on the market. Service provider Virgin alone has captured about 7% of the subscribers. If the wholesale market is competitive and leads to good deals for resellers, these developments limit the possibilities of network operators to raise prices in the retail market.

### Efficiencies

The standard unilateral effects models predict (small) post merger price rises from any merger of substitutes, even if the product overlap is limited, unless the merger leads to efficiency gains that are passed through to consumers. There is evidence that efficiency gains matter in mobile telephony markets. It is generally acknowledged that one reason for the number of network operators per country ranging from 3 to 5 across Europe is that there are significant economies of scale, i.e. fewer operators produce more efficiently than more. Moreover, a second source of efficiencies stems from the fact that, as a given total capacity of frequencies is spread over a smaller group of operators, the ("marginal") cost of network expansion is lowered as, on average, less additional equipment is required to serve additional customers when the frequencies per operator increase. This provides an incentive to compete harder for customers and leads to lower prices. In principle a price concentration study should show these effects. Although the existing studies and studies undertaken in the context of this case have certain methodological limitations (they usually do not account for handset subsidies), they are at least consistent with the existence of efficiencies that are passed on to consumers: they suggest that *higher concentration has no significant effect on prices*.

Once efficiency gains from a merger are accepted, the rationale for remedies that would lead to a redistribution of frequencies, and hence of efficiency gains, can be questioned. The economic theory of unilateral effects does not suggest that an "equal distribution" of the efficiencies is desirable.

In this context the recent decision of the Dutch competition authority, NMa, on the merger of KPN and Telfort is interesting. The NMa confirmed that as long as there is no scarcity of frequencies the impact of a merger on the asymmetry of frequencies should not matter – the merger was approved despite an agglomeration of GSM frequencies of almost 50% in the hands of KPN/Telfort.

### Conclusions

We have noted above a number of factors that effectively addressed unilateral effects concerns in the T-Mobile/tele.ring merger. Nevertheless, the European Commission required a remedy which will lead to a re-distribution of frequencies to H3G and ONE, increasing their excess capacity. This has a certain logic only if the attempt is to strengthen competitors (by redistributing efficiencies stemming from higher frequencies). But this is not the objective of competition policy, which is focussing on consumer welfare. In this context, the rationale of this attempt to increase "symmetry" in the market can be questioned, as consumers may benefit from asymmetries, especially when they make the larger firms more efficient. Against this background the link between the redistribution of frequencies and the competitive effects of the merger is much less clear than at first sight.

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