Vodafone's record breaking merger with Mannesmann

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On the 12 April 2000 the EU Commission gave conditional clearance to the Vodafone AirTouch's acquisition of Mannesmann AG.[1] This brought together Vodafone AirTouch of the UK with mobile networks throughout Europe and beyond, and Mannesmann of Germany a conglomerate with mobile, fixed and industrial operations. The merger was initially a hostile bid but eventually settled down to an agreed take-over. It was the biggest merger to date creating the world's largest mobile telephone operator with 50 million subscribers in 24 countries. It has also been credited with bringing capitalism to Germany, and is widely seen as a watershed in the evolution of Europe's mobile sector securing Europe's (only) lead over North America in telecommunications. Notwithstanding these laurels, it predictably raised competition concerns especially among those European telecommunications operators with less developed international strategies. As a result the merger was subject to intense scrutiny by the EU Commission which received "a significant number of complaints", and often found itself arbitrating between the protagonists to allay third party fears while at the same time not destroying the competitive/commercial logic of the merger.

The Undertakings

The Commission concluded that the proposed merged entity (hereinafter simply referred to as Vodafone) would be able to offer a "*seamless pan-European mobile telecommunications service"* which Vodafone's competitors would find difficult to replicate in the medium term. Thus Vodafone was deemed dominant in this prospective marketplace. It therefore conditionally cleared the proposed merger subject to the divestiture of Orange (which overlapped Vodafone's network in the UK and Belgium), and a set of undertakings which included prohibitions on exclusive roaming and handset purchase agreements, and mandated access to any future pan-European single retail offering and wholesale airtime at rates that enable third parties to enjoy a reasonable return.

The Commission implicitly saw the proposed merger as creating a pan-European mobile operator in a position to eventually substitute international roaming agreements based on national mobile networks with an integrated mobile service spanning a large geographic footprint. This would give Vodafone a competitive advantage which third parties objected too. To calm these fears the Commission mandated a liberal access regime should Vodafone introduce a pan-European retail offering and which would prevent a "price squeeze" on those using it. The Commission mindful of the rapid growth and change in the mobile sector limited these undertakings for a period of three years from its decision.

Competitive Analysis

The Commission concluded that Vodafone would be the only entity capable of delivering "*seamless pan-European mobile telecommunications services*". While this service does not exist, it became the relevant product market for competition law purposes. Vodafone was seen to have a dominant position in this prospective market for three related reasons.

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[1] *Vodafone AirTouch/Mannesmann Case No COMP/M. 1795, 12/04/2000. Also see Commission's Press Release Commission clears merger between Vodafone AirTouch and Mannesmann AG with conditions, IP/00/373, 12/04/00.*

First, the Commission claimed that if Vodafone developed an integrated network it could take advantage of technologies to offer a seamless service of advanced mobile services. Other mobile networks relying on international roaming agreements would have to use an inferior technology to offer a similar service.

Second, the Commission believed that other mobile operators could not replicate Vodafone's geographic footprint in the medium term. The proposed merger brought together 10 networks in 15 countries in the EU after the divestiture of Orange. In order to replicate this geographic coverage ("footprint") other mobile network operators would have to negotiate a large number of new contracts, modify their network administration and configuration, and/or incur potential competition problems if merging. These were seen as major obstacles to replicating Vodafone's footprint.

Third, the Commission saw Vodafone's "unique" advantages generating a "snowballing" effect, although this term is not used by the Commission. If and when Vodafone introduces its seamless service, it would attract new customers because of its superior cost/performance/quality advantages over a wide footprint. This would in turn enable Vodafone to act strategically since other network operators would need access to its network to provide an equivalent service and this could be denied or made difficult and costly ("raising rivals costs") especially if Vodafone were not prevented from operating a "price squeeze" against third party users.

Market Definition

The Commission's decision contrasts with recent EU merger clearance decisions in the mobile sector including Vodafone's acquisition of AirTouch,[2] and from application of the *Access Notice*.[3] All these found that the relevant product market was for all mobile services offered in separate national markets. The traditionalist might here argue that the Commission's efforts should have been confined to increases in market share of second generation (2G) mobile services in Belgium and the UK where there was an overlap due to Orange. This competition concern would have been eliminated with Vodafone's proposed divestiture of Orange.

The Commission, however, sliced the market in a different way. It defined the relevant product market as a service not yet offered to customers. While international roaming services do exist, they are not seamless, and not offered on an integrated network. Instead, they are provided to customers of national mobile networks via bilaterally negotiated international roaming agreements. These agreements are non-exclusive giving the customer a choice of several networks in each country. Neither Vodafone or Mannesmann have an integrated pan-European network for their operating companies, and even though they own numerous networks across Europe these use international roaming agreements with commonly-owned and third party networks in other countries to provide their customers with international coverage. Indeed mobile operators compete in terms of the number of roaming agreements that they can offer their subscribers!

Even if the Commission were correct it would need to show that the merger would strengthen or create a dominant position in an existing market which could be leveraged to more advanced future mobile services related in some way to Vodafone's pan-European footprint. No such market definition was offered or established. Nor was it shown that the merger would give Vodafone a dominant position in some pre-existing product such as international roaming services, or that this was a relevant product market within the scope of the Commission's hypothetical monopolists test. International roaming services are sold nationally, bundled with national mobile calls. Thus it is unclear, without more thorough analysis, whether consumers demand international mobile services independently of national call services. There is no instance where international roaming is sold as a separate standalone service even to corporate customers. It may well be that in competition law terms they are part of a bundled service or cluster market!

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[2] *Telia/Telenor,* Case COMP/M. 1439, 13/10/1999; *Deutsche Telekom/One2One* Case No IV/M.1669, 27/09/1999; *Vodafone/AirTouch*, Case No IV/M. 1439, 21/05/1999; *AT&T/Mediaone*, Case No IV/M.1551, 23/07/1999.

[3] EU Commission, *Notice on the Application of the Competition Rules to Access Agreements in the Telecommunication Sector – Framework Relevant Markets and Principles*, (98/C 265/02) O.J., C 265/1 of 22.8.98.

The matter can also be examined in terms of the relevant geographic market. Past Commission merger clearances have defined the mobile market as national. Pairwise price comparisons between countries show that consumers in one country would not find it cost-effective to switch to mobile call services offered by foreign operators in response to a 5% to 10% price hike in the charges offered by nationally based operators.

The Commission could have legitimately claimed that mobile services are available on a pan-European basis (through international roaming) and therefore define a pan-European international roaming market and/or a wholesale market for network interconnection. It appears not to have taken this tack, and moreover, since inter-operator tariffs or IOTs (the tariffs that networks charge each other for providing international roaming) and retail roaming charges vary considerably between the Member States (and operators) it is doubtful that this approach would have been sustainable.

The question of dominance which would have given the Commission powers to impose undertakings, is also at issue. The Commission's *Press Release* is careful to say that the Undertakings have not been imposed because Vodafone will have a market share that gives it a dominant position but to *"to prevent the emergence of a dominant position"* in a prospective marketplace. This is more than a semantic difference. While some of the operating companies had over 40% market share of national mobile services (Germany, Greece, Belgium), the merger did not increase market shares at the national level. Thus the strength of the Commission's case rested on a speculative claim alleging that Vodafone would have had a 100% of a unique service which at present did not exist.

The Commission's futuristic analysis posed other difficulties. First, the claim that should Vodafone launch a seamless pan European service it would have a first mover advantage which warranted regulatory action can be doubted. As the Commission itself recognised Vodafone's advantage may have been temporary *("competitors would in all likelihood try to build up alternative infrastructures"),* and the mere fact of the merger would have spurred replication of its services. While this may not have been easy or costless (although neither is a £122 billion merger), the evidence was clear that other, mainly incumbent fixed, operators, already had significant ownership interests in mobile network operators in a large number of Member States and were continuing to develop wider footprints through alliances and acquisitions. BT, France Telecom, Deutsche Telekom, Telecom Italia, Telia, Telenor and KPN all have significant cross-border holdings in mobile networks with large footprints and subscriber numbers (Telecom Italia with about 14% of all EU mobile subscribers and Deutsche Telekom with about 9.5% see Table 1). It is particularly noteworthy that apart from Vodafone all these pan-European operators are dominant fixed telecommunications operators who have and are continuing aggressive acquisition strategies to acquire ownership in mobile networks across Europe.
The Commission also recognised that the granting of additional UMTS (Universal Mobile Telecommunications Systems) licences, so-called third generation (3G) mobile networks, would introduce more competition to Vodafone's existing 2G networks which were being merged. Vodafone had to compete for licenses for these networks over the next several years and therefore was not guaranteed of its existing market position in the rapidly evolving mobile sector.

Implications
The Commission's decision has a number of legal and procedural implications which stand out.

Altered market definition. – This decision alters the Commission's market definition for mobile telephony in several respects: (1) the relevant product market was defined narrower than all mobile services; (2) which were not yet supplied to customers; and (3) that there was a prospective pan-European market rather than separate national markets.

The Decline of Overlaps and Market Share - The decision is another example of the decline in the overlap analysis in telecommunications mergers**.** Traditional merger analysis is concerned with increased market share in relevant markets. The theory is that when two entities merge and increase their share of sales or revenues in a relevant market this increases the prospect that the new entity will gain or enhance its market power. If the merger increases the share above 40% to 50% (creates a dominant position) then there is a competition concern. The divestiture of Orange

falls squarely within this approach. However, this is no longer the end of the matter. In *Telia/ Telenor*[4] the overlap requirement was abandoned when the Commission accepted that Telenor and Telia operated in separate geographic markets but nonetheless required them to unbundle their local loops. In *Vodafone AirTouch/Mannesmann* there was no overlap (with the divestiture of Orange) and no market share analysis to support many of the Undertakings.

Speculative Market Analysis – The Commission's decision highlights the increasingly speculative nature of its competitive assessments. The Commission appears to be moving away from overlap analysis to strategic analysis of post-merger actions. This was first seen in *WorldCom/MCI*[5] where the Commission introduced very forward looking predictions not only about dominance but "enhanced dominance" brought about by post-merger snowballing and serial foreclosure through price hikes and degradation of interconnection for rivals. As a result telecommunication mergers are now subject to more sophisticated, speculative and complex analysis of network competition and post-merger strategic behaviour extending a number of years into the future.

Protecting Competitors not Competition. - While the conditions imposed by the Commission are relatively modest if limited to the introduction of new services they can be seen as an unnecessary intervention. Ignoring the fact that other mobile operators have already introduced a "One rate" pan-European roaming tariff and that other mobile operators have every incentive to counter Vodafone, the Commission has apparently seen competition as implying that operators should have identical service offerings. However, if competition law substitutes for innovation and rivalry then it may kill the very competitive outcome it seeks. Too liberal access to innovative products will simply create a culture of free-riding and imitation rather than innovation.

Pro-active case Management – Telecommunications alliances and mergers have a number of features which call for a pro-active approach to the Commission during Phase I. The process differs from many other merger clearances for a number of straightforward reasons. First, the Parties (Commission, merger parties and complainants) are informed repeat players equipped to undertake and advance sophisticated market, regulatory and competitive analysis. Therefore, the Commission is less likely to start proceedings uniformed about the sector. Second, because of the Commission's limited resources it is highly susceptible to well developed third party claims backed by sophisticated economics and regulatory analysis. The rapid pace of change in telecommunications together with its regulated nature, mean that those opposed to a particular alliance or merger can rapidly deploy sophisticated arguments and analysis which could heavily influence the Commission at an early stage. In *WorldCom/MCI* third parties effectively set the terms of the Commission's investigation by introducing network externalities arguments at an early stage which were then difficult for the merging parties to counter (see side bar). Third, the convergence of competition and regulatory laws has led to regulatory concepts and objectives greatly influencing the merger clearance process. This was clearly seen in *Telia/Telenor* where the Commission imposed local loop unbundling as a condition of clearance to accelerate its introduction in Scandinavia consistent with EU regulatory policy under the "1999 Communications Review". These factors all point to the need for the merging parties to take a more proactive stance at an early stage of a Phase I investigation, and most importantly to be familiar with Commission regulatory policy and objectives in the telecommunications sector.

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The author advised Vodafone AirTouch during the Phase One clearance.
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[4] *Telia/Telenor* Case COMP/M.1439, 13/10/1999.
[5] *WorldCom/MCI*, Case IV/ M.1069, 4/5/1999.