



Australian  
Competition &  
Consumer  
Commission

1 April 2009

## Statement of Issues — Vodafone and Hutchison – proposed merger of Australian mobile operations

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed merger of Vodafone's and Hutchison's Australian mobile operations (**proposed merger**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's *Merger Review Process Guidelines* (available on the ACCC's website at [www.accc.gov.au](http://www.accc.gov.au)) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by 17 April 2009 and anticipates making a final decision on 6 May 2009. However, the anticipated timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at [www.accc.gov.au/mergersregister](http://www.accc.gov.au/mergersregister).
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

### Background

5. On 11 February 2009, the ACCC commenced its informal review of the proposed merger of Vodafone's and Hutchison's Australian mobile operations.

## The parties

### Vodafone

6. Vodafone Group plc is the parent company of Vodafone International Holdings BV, which in turn holds a majority interest in Vodafone Australia Limited.
7. Vodafone Group plc is a leading telecommunications company serving 289 million registered customers through its operations in Africa, North Central America, South American, Asia, Europe and Oceania.
8. For the purposes of this Statement of Issues, **Vodafone** refers to the Australian mobile business. Vodafone operates a 2G mobile network in Australia, which is claimed to cover approximately 95% of the Australian population. Vodafone also operates a 3G network that currently covers the metropolitan areas of Sydney, Central Coast, Melbourne, Canberra, Adelaide, Perth, Brisbane and the Gold Coast and Sunshine Coast. Vodafone has announced plans to expand its 3G network to ultimately reach 95% of the population.
9. In addition to its own network, Vodafone shares 3G mobile radio access network (RAN) infrastructure in metropolitan areas with Optus.
10. Vodafone has almost 4 million Australian customers, including over 100,000 mobile broadband (**MBB**) customers. There are currently 170 Vodafone branded stores throughout Australia. Vodafone also retails its products through non-branded retail sites.
11. In the financial year ending 31 March 2008, Vodafone reported total revenue of \$2.44 billion and a consolidated net profit of \$107 million.

### Hutchison

12. The Hutchison Group includes three companies: Hutchison Whampoa Limited (**HW**), Hutchison Telecommunications (Australia) Limited (**HTAL**) and Hutchison 3G Australia Pty Ltd (**H3GA**). HW is the parent company of the Australian mobile business (comprising HTAL and H3GA).
13. HTAL has been an ASX-listed public company since 1999. H3GA is a wholly-owned subsidiary of HTAL. For the purposes of this Statement of Issues, **Hutchison** refers to the Australian mobile business.
14. Hutchison operates a mobile telecommunications network in Australia under the '3' brand.
15. Through its roaming arrangement with Telstra, Hutchison provides access to 2G services in areas which it claims covers 96% of Australia's population.
16. Hutchison operates a 3G network in Sydney / Wollongong, Melbourne / Geelong, Brisbane / the Gold Coast, Adelaide, Canberra and Perth. Hutchison claims that its 3G network footprint currently covers around 57% of the Australian population.

17. In addition to its own network, Hutchison shares 3G mobile RAN infrastructure with Telstra under a joint venture arrangement.
18. Hutchison has over 2 million Australian customers, including over 260,000 MBB customers. There are currently 170 '3' branded stores throughout Australia. Hutchison also retails its products through non-branded retail sites.
19. In the financial year ending 31 December 2008, Hutchison reported revenue of \$1.623 billion but also reported a net loss of \$163.1 million.

## **Other industry participants**

### **Telstra**

20. Telstra is a fully integrated telecommunications provider of fixed-line, mobile and information services. Telstra currently provides mobile services to approximately 9.4 million customers, of which 4.4 million have access to 3G services. Telstra has its own 3G network —Next G — which it claims covers 99% of the Australian population. Telstra also operates a comprehensive 2G network (which is claimed to cover 96% of the population) and shares 3G mobile RAN infrastructure with Hutchison (as discussed above).
21. In the financial year ending 30 June 2008, Telstra reported total sales revenue of \$24.7 billion and retail mobile services revenue of \$4.92 billion.

### **Optus**

22. Optus is the second largest provider of mobile network services in Australia, behind Telstra, and also provides fixed line telecommunications and subscription television services. Optus currently provides mobile services to approximately 7.42 million customers, of which 2.16 million have access to 3G services. Optus claims that its 3G network (Yes G) reaches around 96% of the Australian population.
23. In the financial year ending 31 March 2008, Optus reported total sales revenue of \$7.76 billion. In the half financial year ending 30 September 2008, Optus reported mobile services revenue of \$1.96 billion.

### **Other mobile service providers**

24. Other mobile service providers, besides the mobile network operators (**MNOs**) described above, include mobile virtual network operators (**MVNOs**) and resellers. MVNOs and resellers purchase wholesale services from Telstra, Optus or Vodafone and on-sell mobile services under their own brand. MVNOs also own a small amount of infrastructure allowing them to provide some support services.
25. MVNOs and resellers compete to provide retail mobile telecommunication services to subscribers. Key MVNOs and mobile resellers are: Soul; Dodo; People Telecom; AAPT; Macquarie Telecom; Comtel and TransACT.

26. Virgin and Crazy John’s also provide mobile products at the retail level. These businesses are wholly owned subsidiaries of Optus and Vodafone, respectively.

## **Industry background**

### *Mobile network evolution*

27. Mobile network technology has rapidly evolved from ‘first generation’ (**1G**) mobile phone systems based on cellular networks in the 1980s to ‘second generation’ (**2G**) mobile phone systems such as Global System for Mobile Communication (**GSM**) and Code Division Multiple Access (**CDMA**) in the 1990s. 2G mobile network technology allows for voice, data and text services. These services are sometimes called ‘narrowband’ services.
28. Evolution from 2G systems occurred with the introduction of General Packet Radio Service (**GPRS**) with cellular services combined with GSM or CDMA technologies (**2.5G**). Essentially, 2.5G mobile network technology refers to a 2G system that has implemented a packet switched domain in addition to the circuit switched domain. A 2.5G network provides faster services than a 2G network but uses the same infrastructure.
29. ‘Third generation’ (**3G**) mobile network technology enables Internet, voice, and multimedia services. These services are sometimes called ‘wideband’ services. 3G networks are high capacity digital networks that combine voice with high-speed internet-based services. 3G networks enable users to access a wide range of services, beyond the voice centric 2G and 2.5G networks. Universal Mobile Telecommunications System (**UMTS**), including High Speed Packet Access (**HSPA**) technologies and Wideband Code Division Multiple Access (**W-CDMA**) are types of 3G technologies.
30. ‘Fourth generation’ (**4G**) mobile network technology or ‘long term evolution’ is expected to allow a comprehensive IP solution where voice, data and streamed multimedia can be given to users on an “anytime, anywhere” basis. 4G networks are expected to have significantly higher data rates than previous generations. In Australia, 4G technologies are not expected to come online for at least two years.

### *Industry trends*

31. The Australian mobile market is mature. As at December 2008, the market penetration rate for mobile subscriptions was 111.4% of the Australian population and the 3G penetration rate was 51.6%.
32. Given the high level of penetration for mobile services, in order to gain market share, MNOs must compete to attract subscribers from competitors. This has led to strong retail price-based competition.
33. Industry analysts predict that data services will be the ‘main game’ in the mobile industry space. Consumer demand for data services – both 3G “Internet on your Mobile” (**IOYM**) and MBB – over mobile networks has been significant and is expected to continue. While 3G IOYM and MBB data revenues have grown strongly in recent years, revenues from voice services remain the dominant

revenue stream for mobile service providers. Both voice and data revenue streams will continue to grow over time, however data is likely to grow at a faster rate.

## Market inquiries

34. On 19 February 2009, the ACCC commenced market inquiries regarding the proposed merger. A range of interested parties provided responses, including competitors – MNOs and MVNOs, consumers, mobile phone retailers, industry associations and interested third parties.
35. The ACCC also met with the Australian Communications and Media Authority (ACMA) to discuss technical issues about radiofrequency spectrum.

## Areas of overlap and market definition

36. The following table lists the areas of overlap and potential relevant markets identified by the ACCC for the purposes of reviewing the proposed merger:

<b>Retail and wholesale markets</b>	
<i>Product dimension</i>	<i>Geographic dimension</i>
<u>Wholesale markets</u>	
Domestic transmission capacity services (DTCS)	Distinct transmission routes including: <ul style="list-style-type: none"> <li>• inter-capital transmission;</li> <li>• transmission other than inter-capital routes such as capital to regional routes;</li> <li>• inter-exchange local transmission; and</li> <li>• tail-end transmission</li> </ul>
3G mobile and Internet content	National
Mobile services for the purposes of resale to retail customers	National
Roaming services	National / International
Domestic mobile terminating access service (MTAS)	National
<u>Retail market</u>	
Mobile telecommunications services (including mobile telephony and mobile broadband)	National

37. Issues arose during the course of the ACCC's inquiries regarding the product dimension for retail mobile telecommunications services and radiofrequency spectrum. The ACCC also considered the appropriate geographic dimension for retail mobile telecommunications services.

### *Product dimension*

#### Retail mobile telecommunications services

38. On the basis of information obtained to date, the ACCC considers that a national market exists for the supply of retail mobile telecommunications services to consumers by MNOs, MVNOs and resellers. The market would comprise two key product segments — retail mobile telephony services and retail MBB services.
39. While there are signs of increased fixed-to-mobile substitution and an increased incidence of bundling between fixed and mobile services, the ACCC considers that differences in price, functionality and accessibility are such that retail mobile telecommunications services — including mobile telephony and MBB — are appropriately treated as a separate product market to fixed telecommunications services.
40. In respect of the MBB product segment within the retail mobile telecommunications market, the ACCC considers that, while wireless broadband may provide some constraint on fixed broadband services, this is likely to be to a limited extent on the basis of significant differences in price. The ACCC therefore considers that MBB and fixed broadband services are likely to be in separate markets.

#### Spectrum

41. The ACCC considered whether it was appropriate to consider an acquisition market for spectrum as a relevant market for the purposes of this merger review. In light of the fact that there is not likely to be any *new* spectrum allocated by the ACMA nor is there likely to be any “freeing up” of *existing* allocations in the next two to three years ‘with or without the merger’, the ACCC considered it was more appropriate to characterise spectrum as an ‘input’ in the retail market for the purposes of this matter.

### *Geographic dimension*

42. For some consumers, the relative abilities of the four MNOs to independently provide network coverage outside of metropolitan areas may limit their choice of mobile services provider. Currently, Hutchison, and to a lesser extent, Vodafone, rely on roaming services to provide coverage outside of metropolitan areas. That is, Hutchison and Vodafone customers that travel outside of the area covered by their ‘home network’ can access mobile services via Telstra’s or Optus’ networks.
43. While there are some differences in the quality of services provided to customers that are roaming in non-metropolitan areas, the ACCC considers that the supply of retail mobile telecommunications services on this basis is broadly substitutable to the services offered by Telstra and Optus on their home networks in these areas. Therefore, the ACCC considers that the relevant geographic dimension of competition in the markets for the supply retail mobile services is likely to be national in nature.

***The ACCC invites market participants to comment on market definition.***

The ACCC welcomes any comments from market participants regarding the proposed market definitions, including whether or not retail mobile telephony services and retail MBB services are in the same or separate product markets. The ACCC is also interested in whether there should be a distinction between customer or network type.

The ACCC welcomes any comments as to geographic dimension, including whether there are any significant elements of local competition between MNOs.

**Statement of issues**

44. For the purposes of this Statement of Issues, the issues in this matter are divided into two categories, ‘issues of concern’ and ‘issues unlikely to pose concerns’.

**Issues of concern**

45. The ACCC’s preliminary view is that the proposed merger raises competition concerns in the short to medium term within the mobile telephony and MBB segments of the national market for the supply of retail mobile telecommunications services.
46. The ACCC notes the proposed merger would result in increased concentration from four to three MNOs in a market which is already highly concentrated, and that the prospect for a new entrant MNO of the scale and scope necessary to provide a competitive constraint on existing MNOs is practically non-existent. The ACCC also considers that MVNOs and resellers are unlikely to constrain the merged entity, particularly as they rely on wholesale acquisition of mobile services from MNOs.

***Removal of Hutchison as a vigorous and effective competitor***

47. The ACCC is concerned that the removal of Hutchison as a vigorous and effective competitor will lead to increased prices for customers in the retail mobile telephony and MBB services segments in the retail mobile telecommunications services market.
48. The ACCC understands that Hutchison is consistently attracting new subscribers and has been gradually increasing its subscriber share and revenue share over time. Hutchison has competed aggressively for market share in the national market for supply of retail mobile telecommunications services, consistently attracting a relatively high proportion of customers from the other three MNOs.
49. The ACCC is of the view that Hutchison and Vodafone are each other’s closest competitors, focusing on price-sensitive customers in metropolitan areas. Hutchison is a strong competitor in the supply of lower-priced postpaid mobile products, while Vodafone is a strong competitor in the supply of prepaid mobile products. The ACCC’s preliminary view is that the proposed merger may increase the potential for Vodafone to exercise unilateral market power.

***Increased potential for coordinated effects***

50. The ACCC's preliminary view is that the proposed merger may also increase the potential for coordinated effects in the mobile telephony and MBB segments of the retail mobile telecommunications market. In reaching this preliminary view, the ACCC notes that:
- the four MNOs have a combined market share of almost 95% in the market for the supply of retail mobile telecommunications services;
  - prices are easily observed at the retail level;
  - products are relatively homogeneous;
  - demand for retail mobile telephony is relatively stable and demand for retail MBB is growing;
  - there is a high frequency of interaction between MNOs; and
  - barriers to entry as an MNO are very high, such that supra-competitive pricing is unlikely to induce new entry.
51. The ACCC is also considering the extent to which the merged entity would have an increased ability to observe its competitors' intentions for network investment as a result of its being party, at least initially, to the two network sharing joint venture (**JV**) arrangements (the Telstra and Hutchison JV and the Optus and Vodafone JV).
52. As noted above, the ACCC considers Hutchison to be a vigorous and effective competitor in the retail telecommunications services market. The ACCC is concerned that the removal of Hutchison as an independent competitor in the market may increase the potential for coordinated effects amongst remaining market participants.



***The ACCC invites market participants to comment on the possible unilateral and coordinated effects of the proposed merger.***

Please provide comments on the following and preferably provide further information and specific examples in relation to:

- Whether Vodafone and Hutchison are each other's closest competitors for the supply of retail mobile telecommunications services, either to lower-spend mobile customers, or any other mobile customer segment;
- Whether Hutchison and/or Vodafone is a particularly aggressive price-based competitor, and if so, in which particular mobile customer segments;
- Whether Telstra and Optus are unlikely to act as effective competitors to the merged entity for lower-spend mobile services;
- Whether, in the event that Vodafone and Hutchison merge their mobile network operations, the merged entity would be in a position to increase prices for mobile services in a sustainable manner;
- Whether, in the absence of Vodafone and Hutchison merging their mobile network operations, there would be less aggressive price competition in the retail market;
- The likelihood that Vodafone and Hutchison, in the event that they merge their mobile operations, would compete aggressively on price and/or product innovations, and if so, in which particular mobile customer segments;
- The likelihood that Telstra and Optus, or any other supplier of retail mobile services (such as an MVNO), would constrain the merged entity's attempts to increase prices for lower-spend mobile services; and
- Whether there are circumstances in the mobile market that make coordinated effects more likely to occur.

***Increased potential for infrastructure-based competition***

53. The forward-looking nature of merger analysis means that the ACCC, when analysing the competitive effect of a merger, must take into account the changing nature of the market. In this regard, the merger parties submit that the merged entity would be of sufficient size and scope to compete strongly against Optus and Telstra particularly in data-intensive markets.
54. The ACCC considers that, in the longer term, the merged entity may be able to develop as a stronger infrastructure-based mobile telecommunications services provider due to the increased scale of its operations. However, the ACCC recognises that significant investments in network coverage and capacity will be necessary to achieve this end.

55. As part of its investigation, the ACCC will further examine:
- the extent to which the effective integration of the merged entity may be hindered by one or both of the existing network sharing JV arrangements with Telstra and Optus;
  - whether the costs of terminating one or both of these JV arrangements, along with the integration costs of the proposed merger, would prevent the merged entity from undertaking major network investments in the short to medium term;
  - whether the merged entity can combine the spectrum owned by each party in an effective manner;
  - the likely timeframes for the merged entity’s network enhancements;
  - the likely impact of such network enhancements on competition with other MNOs;
  - whether significant network investments would be likely to be made in any case in the absence of the proposed merger; and
  - whether infrastructure-based competition will increase in the longer term with or without the proposed merger.
56. These issues will be relevant in considering the duration of any competitive harm arising from the proposed merger in the retail telecommunications services market. As noted above, the ACCC is concerned that the merger may raise competition concerns in the short to medium term. The ACCC notes the merger parties’ submission that, in the longer term, the merged entity may develop a network of a similar scale and scope to its competitors.
57. The ACCC intends to explore the duration of anti-competitive harm and the likelihood and timeliness of any advantages for competition eventuating as a result of the proposed merger.

***The ACCC invites market participants to comment on the possible longer term competitive benefits from the proposed merger.***

The ACCC welcomes any comments from market participants regarding the potential for the merged entity to be a stronger infrastructure-based competitor in the longer term, including the extent to which the merged entity will face any technical or legal barriers to network upgrades or expansion.

**Issues unlikely to pose concerns**

58. The ACCC’s preliminary view is that competition issues are unlikely to arise in the five wholesale markets.

59. The ACCC also considers that there are unlikely to be competition concerns posed by the aggregation of the merger parties' radiofrequency spectrum (a key input in the retail market).

### *Wholesale markets*

60. The ACCC understands that Hutchison has little or no presence in the markets for the:
- the acquisition of domestic transmission capacity services (**DTCS**);
  - the supply of mobile services for the purposes of resale to retail customers; and
  - the supply of domestic and international roaming services.
61. The ACCC considers that Telstra and Optus would continue to constrain the behaviour of the merged entity in these markets post-merger.
62. In the markets for 3G mobile and Internet content, and mobile terminating access services (**MTAS**), the ACCC is of the view that the proposed merger is unlikely to substantially lessen competition. Indeed, the merger may leave the merged entity in a stronger position to compete more effectively with Telstra and Optus in these markets.

### *Aggregation of spectrum*

63. Hutchison currently owns spectrum in the 850MHz, 1800MHz, and 2100MHz frequency bands. Vodafone currently owns spectrum in the 900MHz, 1800MHz and 2100MHz frequency bands. The merger parties' spectrum holdings are in all metropolitan capital cities, large regional cities, and some regional/rural areas.
64. The ACCC has considered whether the aggregation of the merger parties' spectrum will increase the ability and incentive of the merged entity to hoard unused spectrum with the effect of raising barriers to expansion for existing MNOs.
65. The ACCC considers that a substantial lessening of competition is unlikely to arise in relation to the aggregation of spectrum.
66. In assessing a merger pursuant to section 50 of the *Trade Practices Act 1974*, the ACCC must consider the effects of the transaction by comparing the likely future state of competition if the transaction proceeds (the 'with' or 'factual' position) to the likely future state of competition if the transaction does not proceed (the 'without' or 'counterfactual' position).
67. The ACCC's preliminary view is that 'without' the merger, it appears unlikely that the merger parties would be likely to sell their spectrum. Therefore, while the merged entity has an increased incentive to hoard its spectrum, it may have an increased incentive to use previously unused spectrum to enhance network capacity or rollout a new network in the longer term.

***The ACCC invites market participants to comment on the wholesale markets and spectrum aggregation.***

The ACCC welcomes any comments on these issues, including whether there are likely to be competition concerns in these markets.

In terms of spectrum, the ACCC welcomes comments on the likelihood of any currently used spectrum being ‘freed’ up in the near future for use by an MNO.

**ACCC’s future steps**

68. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
69. The ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC’s assessment of this matter.
70. Submissions are to be received by the ACCC no later than **17 April 2009**. The ACCC will consider the submissions received and will, in conjunction with information and submissions already provided by the parties, come to a final view as to the appropriate course of action to take to resolve any competition concerns that remain.
71. The ACCC intends to publicly announce its final view by **6 May 2009**. However the anticipated timeline may change in line with the *Merger Review Process Guidelines*. A Public Competition Assessment for the purpose of explaining the ACCC’s final view may be published following the ACCC’s public announcement.