

***Case No COMP/M.4035 -  
TELEFÓNICA / 02***

Only the English text is available and authentic.

**REGULATION (EC) No 139/2004  
MERGER PROCEDURE**

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Article 6(2) NON-OPPOSITION  
Date: 10/01/2006

***In electronic form on the EUR-Lex website under document  
number 32006M4035***



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 10.01.2006

SG-Greffe(2006) D/200059

In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EC) No 139/2004 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus [...]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE  
ARTICLE 6(1)(b) DECISION

**To the notifying party :**

Dear Sir/Madam,

**Subject: Case No COMP/M.4035 - Telefónica/O2  
Notification of 14 November 2005 pursuant to Article 4 of Council  
Regulation No 139/2004<sup>1</sup>**

1. On 14 November 2005 the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation No 139/2004 (the Merger Regulation) by which the undertaking Telefónica S.A. (“Telefónica”) acquires within the meaning of Article 3(1)(b) of the Merger Regulation control of O2 Plc (“O2”) by way of a public bid announced on 31.10.2005.
2. In the course of the proceedings, Telefónica submitted undertakings as a result of which the deadline of the first phase was extended to 10 January 2006. The proposed commitments were designed to eliminate competition concerns identified by the Commission, in accordance with Article 6(2) of the Merger Regulation. After examination of the notification and in the light of these commitments, the Commission has concluded that the operation falls within the scope of the Merger Regulation and does not raise serious doubts as to its compatibility with the common market and the EEA agreement.

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<sup>1</sup> OJ L 24, 29.1.2004 p. 1.

## **I. THE PARTIES**

3. Telefónica is a Spain based global telecommunications operator present in Europe, Africa and South America which is active in most of the electronic telecommunications segments (fixed and mobile telephony, business services, data transmission, Internet access, marketing of directories and guides, CRM services, broadband and undersea cable infrastructure). In the EEA, Telefónica presently provides mobile and fixed telecommunication services in Spain and also in the Czech Republic (through its recently acquired subsidiary Cesky Telecom).
4. O2 is a UK based provider of mobile telecommunication services present in the UK, Germany, Ireland and the Isle of Man.

## **II. THE CONCENTRATION**

5. Telefónica announced on 31.10.2005, in accordance with rule 2.5 of the UK's City Code on Takeovers and Mergers, the launch of an irrevocable takeover offer to acquire the total issued and to be issued share capital of O2. It is expected that the offer will close in January 2006.
6. Telefónica will acquire all shares and thereby sole control over O2. The proposed operation constitutes a concentration within the meaning of Art 3(1)(b) of the Merger Regulation.

## **III. COMMUNITY DIMENSION**

7. The combined aggregate worldwide turnover of all the undertakings concerned exceeds 5,000 million Euro (in the year 2004: Telefónica: 32,323 million Euro; O2: 9,745 million Euro), the aggregate Community-wide turnover of each of the two undertakings concerned exceeds 250 million Euro (in the year 2004: Telefónica: [...] million Euro; O2: [...] million Euro) and they do not achieve more than 2/3 of their turnover in a single EU Member State. The concentration has therefore Community dimension in accordance with Article 1(2) of the Merger Regulation.

## **IV. COMPETITIVE ASSESSMENT**

8. Both Parties provide telecommunication services on the retail level. While O2 is only active in mobile telecommunication services, Telefónica offers both mobile and fixed telephony. Both Parties offer wholesale termination and wholesale international roaming services on their networks in different countries. Moreover, they are active in the provision of advanced pan-European mobile telecommunication services to multinational companies.

### **1. Relevant market**

#### ***Wholesale call termination services on fixed and mobile networks***

9. Call termination consists of the service offered by network operator B to operator A to terminate traffic originating on A's network. Call termination services, thus, allow users of different networks to communicate with each other. It is a wholesale service that the different operators of telecommunication

networks provide to each other through interconnection agreements. Call termination is used as an input for the provision of downstream retail communication services.

10. As was confirmed in several previous Commission decisions<sup>2</sup>, there cannot be a substitute for call termination on each individual network since the operator can only reach the relevant end-customers by terminating the call on that specific network. Each individual network therefore constitutes a separate relevant call termination market. This equally applies to fixed and mobile telecommunication networks. Accordingly, also the Recommendation on relevant markets<sup>3</sup> distinguishes voice call termination on individual networks (mobile or fixed) as separate markets. Each network operator has, therefore, by definition a 100% market share in the market for call termination in the own mobile or fixed network.
11. The market for mobile call termination as well as the market for fixed call termination is considered to be essentially national in scope because of regulatory barriers according to which authorisations to operate a network are only granted for territories which are not wider than national. Mobile as well as fixed networks normally provide national coverage and the scope of the wholesale offer is thus national.

#### ***Wholesale international roaming services***

12. As opposed to termination, international roaming is a service which is only relevant for the provision of mobile telecommunication services and not of fixed telecommunication services. International roaming services enable mobile telecommunication operators to offer to their customers the possibility to travel abroad and to still give and receive calls<sup>4</sup> with their cell phones. To this aim, operators engage in agreements that grant access and capacity in a country other than the one in which they operate.
13. The provision of wholesale international roaming to foreign mobile network operators satisfies primarily a demand by foreign mobile network operators whose main objective is to enable them to offer to their own subscribers a mobile telecommunication service, which is not limited to the territory in which they have their own physical network. Downstream there is the corresponding demand of the subscribers to be able to use their mobile phones cross-border.
14. This market definition reflects the current situation in the market as it has evolved in the recent past. Originally, the home network operator could not

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<sup>2</sup> COMP/M.1493-Telia/Telenor, COMP/M.2803-Telia/Sonera, COMP/M.3806-Telefónica/Cesky Telecom.

<sup>3</sup> Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services; OJ 8.5.2003, p.45.

<sup>4</sup> And also send and receive SMS and data.

direct their clients' roaming traffic ("outbound traffic"<sup>5</sup>) which these create abroad to specific networks in the respective other country. Due to the absence of efficient steering techniques, international roaming traffic has traditionally gone through any available operator's network in the countries where retail clients of mobile services are travelling. On this basis the Commission concluded recently on a preliminary basis that in the past the provision of wholesale international roaming services in certain operator's networks constituted separate markets<sup>6</sup>.

15. However, network operators can and do increasingly choose the network on which their clients roam outside of their home country. The home country operator can to a major extent determine which foreign network operator will receive its roaming traffic using "traffic steering" mechanisms, the most important of which is the use of "preferred lists" on their customers' SIM cards. These preferred lists are updated remotely using "over the air" technology (OTA).<sup>7</sup>
16. The Parties indicate that from a technical point of view they can steer [...] of their total outbound traffic. The market investigation has shown that the percentage of traffic network operators can steer to a foreign network can arrive to 75%-80%. The subscribers themselves have in principle the possibility to choose the roaming provider manually. However, most customers do not use this option but accept their home network operator's choice.
17. For this choice in principle all foreign network operators in the respective country are eligible. The investigation in this case has shown that while specific discounts are agreed upon only with selected operators, standard roaming agreements exist with all or almost all operators in one country. Historically, operators have often entered into multiple roaming agreements mainly in order to reach the best possible roaming coverage. However, even if national coverage of the different operators is largely comparable, still multiple agreements are concluded. This strategy does not create significant costs due to the absence of any minimum purchasing requirements in the standard roaming agreements and allows multi-sourcing as well as switching between different roaming providers. Consequently, the old market definition which regards every individual network as separate market is not appropriate any longer. It can be concluded that networks compete to a very large extent with each other on a national level.

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<sup>5</sup> "Outbound traffic" are the calls which a network operator's clients make while being abroad. For this traffic, the home network operator needs to buy "outbound roaming" from the respective foreign network operator(s). "Inbound traffic" are the calls which are made on an operator's own network by clients of foreign mobile telecommunication providers, i.e. visitors. The operator who allows the foreign clients to make these calls on its network sells "inbound roaming" to the respective foreign network operator.

<sup>6</sup> See IP/05/161 "Commission challenges international roaming rates for mobile phones in Germany" and IP/04/994 "Commission challenges UK international roaming rates".

<sup>7</sup> Over-The-Air is a standard for the transmission and reception of application-related information in a wireless communications system.

18. In previous decisions<sup>8</sup> the Commission has considered that this market is national in scope given that authorisations to provide mobile telephony services are only granted for national territories by national authorities and wholesale contracts can only be subscribed with companies that have an authorisation to operate in a given country. This conclusion can also be drawn in the present case.

### ***Retail fixed line communication services***

19. Fixed line telephony retail services comprise the provision of connection services or access (at a fixed location or address) to the public telephone network for the purpose of making and/or receiving calls and related services. The Recommendation on relevant markets<sup>9</sup> distinguishes between local/national and international services, both for residential and business customers.
20. The transaction only concerns international services in view of their vertical relation between call termination services in the countries to which the international calls are directed. For the purposes of this case the exact market definition may be left open, since the merger does not raise any competition concerns in this respect regardless of the market definition in the provision of retail fixed line communication services.
21. Due to the existing regulatory barriers and the usual complete national coverage of the networks the Commission has always considered that the geographic market for retail services in a fixed network is national in scope<sup>10</sup>.

### ***Retail mobile telecommunication services***

22. The Commission has in previous decisions delineated a market for the operation of mobile telecommunication networks and therefore the provision of mobile telecommunication services irrespective of the technical standards used (analogue, digital GSM900/1800).<sup>11</sup>
23. In the case *Vodafone/Singlepoint*<sup>12</sup>, the Commission has considered whether a distinction between business customers and private customers should be made. The Commission found that customers can choose from a wide range of tariff packages and if prices for business tariffs were to rise well above a competitive level, corporate customers could, if necessary, switch to residential customer tariffs. The exact market definition was, however, left open. In the case *France Télécom/Amena*<sup>13</sup> the investigation showed that the needs of private

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<sup>8</sup> See for example Case COMP M. 2726 KPN/E-PLUS, COMP M 2469 Vodafone/Airtel, COMP M. 1863 Vodafone/BT/Airtel, COMP M 2803 Telia/Sonera and COMP/M.3806 - Telefónica/Cesky Telecom.

<sup>9</sup> Idem footnote 3.

<sup>10</sup> See for example the decision taken recently for case COMP/M. 3806– Telefónica/Cesky Telecom.

<sup>11</sup> M. 1430 Vodafone/Airtouch, M. 1439 Telia/Telenor.

<sup>12</sup> M. 3245 Vodafone/Singlepoint

<sup>13</sup> M.3920 France Télécom/Amena

individuals, small and medium businesses, and multinational corporations (MNCs) differ especially in terms of roaming services. The investigation also indicated that the frontier among the three groups of customers is difficult to draw. The exact definition can, however, be left open for the purposes of this case since the analysis of the case does not change irrespective of the concrete market definition.

24. As regards retail services of international roaming, the Commission has generally considered that they are part of a package of mobile services. As a consequence, they should not be considered as a separate product market but as part of the retail mobile telecommunication services market. In the present case the market investigation showed that international roaming is an important part of the retail mobile services, in particular for business customers. However, for the purposes of this case it is not necessary to decide whether it is a separate market.
25. Customers are only able to obtain mobile telecommunication services from licensed network operators, and licensing takes place on a national basis. Taking into account the existing regulatory barriers, the market for the provision of mobile retail telecommunication services is, therefore, national in scope.

#### ***Advanced seamless pan-European mobile telecommunication services for MNCs***

26. In previous decisions the Commission has discussed the existence of an emerging market for advanced seamless pan-European mobile telecommunication services to international mobile customers, in particular MNCs<sup>14</sup> (“pan-European services”). This market enables multinational companies to strike better price deals through European-wide requests of proposals, and to rationalize more effectively their mobile phone expenses thanks to the combination of billing systems. It also includes advanced services such as messaging services and content/data services, the possibility for roaming customers to move from a country to another with no difference in the service (“virtual home environment”) and interoperability in particular for data transfer (“seamless services”)<sup>15</sup>.
27. The results of the market investigation indicate that emerging demand for such pan-European services exists. Most network operators stated that their customers require pan-European services. This is also confirmed by the emergence of international alliances of network operators which have the clear aim to respond to this demand. Two alliances have emerged in the past two to three years: the FreeMove alliance and the Starmap alliance, who both offer pan-European services in competition to the largest mobile telecommunication provider in the EEA, Vodafone. Telefónica participates in FreeMove, while O2 is a member of Starmap.

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<sup>14</sup> see for example COMP/M. 1795 Vodafone / Mannesmann; COMP/M. 2469 Vodafone/Airtel; COMP/M.3806 - Telefónica/Cesky Telecom

<sup>15</sup> Such as short code dialling to access voicemail; see also COMP/M.1795 Vodafone Airtouch / Mannesmann.

28. This market is still at an emerging stage and is based on multi-national partnership arrangements among operators, except, to a large extent, for Vodafone<sup>16</sup>. According to the investigation carried out by the Commission in the case France Télécom / Amena, the territories covered by the services are wider than national but material provisions of the contracts for MNCs are currently often still negotiated individually on a national level. The market investigation confirmed that relations between MNCs and mobile operators are thus based on bilateral contracts subscribed between each subsidiary of the MNC based in a given country and each national operator based in the same country.
29. However, it has to be noted that a single point of contact, one bill for a large territory, standardized international roaming costs and the at least partially existing seamlessness is perceived as a significant advantage of alliances and clearly distinguishes pan-European services from “patchwork services” by which MNCs combine different national offers on their own. It can be concluded, that in the current stage of this emerging market national patchwork services are still to some extent substitutes for truly pan-European services. However, it can be expected that with the further development and integration of services within the alliances / the Vodafone group, the integrated pan-European offers will be clearly differentiated from patchwork services. Already now a number of MNCs do not consider non-alliance offers as viable alternatives to alliance offers due to the provision of advanced services and the wide geographic coverage.
30. For the purposes of this case, the market is therefore considered as encompassing both alliance and non-alliance offers taking into account that non-alliance offers are only imperfect substitutes for integrated services which will probably lose their attractiveness in the future leaving only the alliances having integrated networks and Vodafone as mobile telecommunication providers of pan-European services in this market.
31. Accordingly, the geographic market would have a national component as far as patchwork services are regarded. All truly pan-European offers, however, would point towards a European scope of the market, since MNCs issue pan-European bids with the main providers being alliances and groups with a wide-spread presence all over Europe. This pan-European perspective already exists to a considerable extent and will be further enhanced in the future.
32. It is, however, for the purposes of this case not necessary to clearly define the product and the geographic market, since it will not change the outcome of the analysis.

## **2. Competition Analysis**

33. The Parties are active in the same economic sector of telecommunications services, but - with the exception of pan-European services in the framework of

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<sup>16</sup> Vodafone most often does not need to team up with another operator as it has the necessary European-wide footprint to offer the discussed services.



the respective alliances - in different geographic areas. Effects from the merger might result with respect to three areas:

- **Wholesale call termination services** are a necessary input for network operators in order to provide mobile and fixed telecommunication services on the retail level. Telefónica provides call termination in Spain and the Czech Republic and O2 in UK, Ireland and Germany.
- **Wholesale international roaming services** are also a necessary input for network operators in order to be active in the retail mobile telecommunication services markets. The Parties provide these services in the countries mentioned above.
- **The emerging market of advanced seamless pan-European mobile telecommunication services for MNCs.** Both Parties are through their alliances active in this emerging market.

#### *Wholesale call termination services*

34. In Spain and the Czech Republic, Telefónica holds a 100% market share in the provision of termination services on its fixed and mobile networks (in the Czech Republic through its subsidiary Cesky Telecom). These markets are vertically linked to the British, Irish and German retail markets for the provision of mobile telecommunication services where O2 is active as a mobile communication provider with a market share of 45% in Ireland, 24% in the UK and 11% in Germany.
35. On the other hand, O2 in Ireland, the UK and Germany holds a 100% market share in the provision of termination services on its mobile networks. These markets are vertically linked to the Spanish and Czech retail markets for the provision of retail mobile telecommunication services where Telefónica is active. In retail mobile telecommunication services, Telefónica holds market shares of 54% in Spain and 49% in the Czech Republic. The same vertical relation applies to the markets for international fixed telecommunication services provided by Telefónica to residential and business customers in Spain and the Czech Republic, where Telefónica has market shares of between 65% and 71%.
36. The proposed transaction cannot lead to competitive foreclosure effects on any of these markets. A discrimination of foreign telecommunication operators would be technically difficult since international calls are mostly made over international carriers who act as intermediaries between the telecommunication operators. In most cases, it would, therefore, not be possible for the Parties to know the identity of the customer purchasing termination. It is only possible to identify the exact origin of the international traffic terminated on a network where there is a direct interconnection with the foreign telecommunication operators. The market investigation has confirmed that even in these cases discrimination is not likely to occur, since there are apparently no obstacles which would prevent a foreign telecommunication provider to switch to an international carrier in order to acquire termination in case of discrimination.

## *Wholesale international roaming*

37. As a result of the market investigation and the competition analysis it has become evident that the transaction raises serious doubts on the market for wholesale international roaming. An important factor in the competition analysis is the role of the alliances.
38. It is expected in the market that O2 will after the merger leave the Starmap alliance and that Telefónica intends to integrate O2 into FreeMove. The competition concerns arise from the elimination of O2 as a provider of international roaming ready to enter into reciprocal agreements which provide for a mutual exchange of traffic.

### Background: Alliances

39. Two different alliances in the mobile telecommunication sector were created in the recent years: FreeMove and Starmap. It appears that the internalisation of traffic has been the starting point. When technical possibilities evolved to better steer outbound roaming traffic on specific networks, the first reaction in particular of the major most internationalised group - Vodafone - was to internalise outbound roaming traffic to a large extent. Vodafone used the vertical integration which resulted from its international footprint and started to buy wholesale international roaming increasingly from own group affiliates than from third party network operators.
40. It seems that an important goal in particular of the FreeMove alliance was to react on this new development and to also “internalise” traffic in the networks of the FreeMove alliance members, thereby simulating the effects of vertical integration by agreements. Another aim was to be better able to respond to demand from multinational customers, which was also a predominant motivation for the creation of Starmap.
41. **FreeMove:** The members of the FreeMove alliance are four of the largest incumbents in the EEA: Telefónica Móviles (Telefónica), Orange (France Télécom), TIM (Telecom Italia) and T-Mobile (Deutsche Telekom). The FreeMove alliance operates in the following European countries: Germany, Italy, United Kingdom, France, Spain, the Netherlands, Austria, Slovakia, the Czech Republic, Hungary, Belgium and Greece<sup>17</sup>. The alliance’s targets are: (i) to steer more outbound international roaming traffic over member networks, (ii) to make combined offers to multinational customers and (iii) to develop and offer seamless services which allow for a “virtual home” experience according to which a customer does not see any difference when using the mobile phone in the home country or abroad. For the steering of the outbound traffic it was agreed that [...] total traffic should be directed on member networks [...].
42. **Starmap:** In the Starmap alliance a number of smaller network operators co-operate. The Starmap alliance mainly intends to make joint offers to multinational customers. [...] Apart from O2 the following companies

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<sup>17</sup> Subsidiaries of FreeMove members also exist in the countries Luxemburg, Poland and Denmark. They have, however, not been brought within the scope of the alliance.

participate: Amena (Spain), One (Austria), Pannon GSM (Hungary), Sunrise (Switzerland), Telenor Mobil (Norway), Wind (Italy), Sonofon (Denmark) and Cesky-Eurotel (the Czech Republic). Starmap members are present in the following countries: Austria, Czech Republic, Denmark, Germany, Hungary, Ireland, Italy, Norway, Spain, Switzerland and the United Kingdom. Amena has, however, been bought by France Télécom whereas Cesky-Eurotel has been bought by Telefónica.

43. **Vodafone-Eurocall:** Vodafone is the largest mobile telecommunication operator in the EEA with an own footprint in 12 EEA-countries. In 8 other EEA-countries, Vodafone has entered into partnership agreements and has thereby created the Eurocall network.
44. A number of network operators have not joined any alliance. In the EEA-countries where either FreeMove or Starmap are active, these are in essence: KPN (the Netherlands, with its subsidiaries E-plus in Germany and Base in Belgium), Meteor (Ireland), Bouygues (France), Tele.ring (Austria)<sup>18</sup>, Cosmote (Greece), Q-Telecom (Greece). In the following, they will be referred to as the “independent” network operators. The table below gives an overview over the footprint of the alliances / groups and independents in the area where FreeMove and Starmap are active.

	<i>FreeMove</i>	<i>Starmap</i>	<i>independent</i>	<i>Vodafone Eurocall</i>
<b>Spain</b>	Telefónica	Amena ( <i>bought by France Télécom</i> )		X
<b>Czech Republic</b>	T-Mobile	Cesky-Eurotel ( <i>bought by Telefónica</i> )		X
<b>UK</b>	Orange, T-Mobile	O2		X
<b>Germany</b>	T-Mobile	O2	E-Plus (KPN)	X
<b>Ireland</b>		O2	Meteor	X
<b>Italy</b>	TIM	Wind		X
<b>France</b>	Orange		Bouygues	SFR ( <i>participated by Vodafone</i> )
<b>Netherlands</b>	Orange, T-Mobile		KPN	X
<b>Austria</b>	T-Mobile	One	Tele.ring	Mobilkom Austria ( <i>partner of Eurocall network</i> )
<b>Slovakia</b>	Orange			X
<b>Hungary</b>	T-Mobile	Pannon GSM		X
<b>Belgium</b>	Mobistar (France Télécom)		Base (KPN)	Proximus ( <i>participated by Vodafone</i> )
<b>Greece</b>	TIM		Cosmote, Q-Telecom	X
<b>Denmark</b>		Sonofon		TDC ( <i>partner of Eurocall network</i> )
<b>Norway</b>		Telenor Mobil		X

Orange (France Télécom); T-Mobile (Deutsche Telekom); TIM (Telecom Italia)

<sup>18</sup> The proposed acquisition of Tele.ring by T-Mobile Austria is currently under examination by the Commission, Case M. 3916.

## Concerns raised

45. The merger has raised a number of concerns with respect to wholesale international roaming services. Complaints did not focus on the “mere” vertical integration but emerged from the expected change of O2’s alliance membership and the subsequent shift in the competitive landscape in mobile telecommunication. With the likely switch of O2 from Starmap to FreeMove following the merger, the number of independent / Starmap providers in the UK, Germany and Ireland will be reduced (in Germany and Ireland from two to one, in the UK from one to zero).
46. This reduction of independent suppliers is closely linked with a reduction of buyers of international roaming from independent network operators since O2’s outbound roaming traffic will in the future be steered away from its current providers of international roaming to the FreeMove members in their respective countries [*due to the traffic steering target*]. This concern applies to the FreeMove countries Italy, France, Netherlands, Austria, Slovakia, Hungary, Belgium and Greece. Network operators intending to buy in the UK, Germany and Ireland would face O2 as future FreeMove member both in terms of their own purchases of international roaming from O2 as well as regarding O2’s purchases from them.

## International roaming contracts

47. Both the above mentioned aspects of the concerns raised – a reduction of number of suppliers and at the same time of the number of buyers - are closely related to each other due to the commonly practised reciprocity of contracts and the reciprocal exchange of traffic in wholesale international roaming.
48. In order to provide international roaming services, operators of a given country have usually engaged in bilateral agreements with all operators of other countries. These are based on the GSM Association’s standard international roaming agreement (STIRA). The STIRA provides for wholesale roaming to be charged on the basis of the operator’s standard ‘inter-operator tariff’ (IOT), which is published by the GSM Association. The IOT is the tariff the visited network levies on the home network for the use of the visited network. Operators are required by the STIRA to offer the IOT to all foreign operators without discrimination. However, operators commonly negotiate in separate discount agreements IOT discounts which can be unconditional or volume based.<sup>19</sup>
49. The network operator, who buys wholesale outbound international roaming, steers its own subscribers who travel abroad onto the “preferred” network within the respective foreign country. The wholesale per-minute-price for

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<sup>19</sup> To date, visited networks directly charge foreign networks only for calls which have originated by the latter’s subscribers while roaming onto the visited network (mobile originated calls). The situation differs with respect to incoming calls. Since network operators in the EU have applied the “calling party pays principle” and do not charge their customers for mobile terminated calls, there have generally not been wholesale roaming charges levied for incoming roamed calls. Therefore, any reference made in this text to wholesale international roaming prices or IOTs concerns the prices charged or the IOTs applied for outgoing roamed calls only.

international roaming in a foreign country which the home network operator has to pay is mostly linked to the quantity of roaming traffic that is sent to the foreign network operator. The market investigation has shown that there are significant discounts dependent on the volume of traffic sent on the IOT.

50. Usually, a provider of international roaming also buys international roaming from the respective purchaser at the same time. Agreements are almost always negotiated in parallel on a reciprocal basis. Price and volume schemes of discount agreements are usually set up reciprocally for both sides, however, not necessarily always symmetrically. Only in very exceptional cases one-way agreements are concluded. This entails that the quantity of traffic to be mutually exchanged and the decision of the partners to choose one another as preferred provider is an important part of the negotiations.
51. Both sides – buying and selling of international roaming – are closely connected since a network operator creates profits to the foreign network operator by choosing this one as a preferred network. The home network operator himself will only gain profits when receiving traffic in return. A network operator A will as a consequence in general only choose B as a preferred provider and buy large volumes of wholesale international roaming from network operator B if B in turn also chooses A as preferred provider and also buys large volumes from A. The discounts on IOT will then balance out differences in traffic exchanged. It should be borne in mind that the home network operator therefore does not necessarily steer its own subscribers on that foreign operator's network which offers the lowest discounted IOT for these visitors, but to the operator who provides for the highest overall revenue to the home network operator as the best combination of price and traffic sent in return.

#### The alliance rules

52. The reciprocity of the agreements and the overall calculation of revenues including both the purchase and the sale of international roaming lead to a situation similar to a barter trade. If both sides require high international roaming prices, these costs cancel out if both sides send similar amounts of traffic.
53. [...], the FreeMove members do not in principle refuse to sell wholesale international roaming to non-members. However, due to their alliance obligations they are to a large extent not any longer ready to buy international roaming from non-members in return. The price for international roaming thereby becomes essential for the buyer with the “net” outbound traffic. Since the own international roaming costs cannot be “cleared” against similar international roaming revenues, this represents a real increase in rivals' costs and only affects providers outside of the FreeMove alliance, i.e. everyone except for the large four incumbents (and except for Vodafone which is to large extent independent from other wholesale international roaming providers due to its own large footprint).
54. The Parties argue that the [...].

55. [...].<sup>20</sup> [...].<sup>21</sup> It is clear that no alliance member is forced to be in the alliance. Even a total “opt-out”, i.e. an exit from the alliance, is possible. However, the clearly stated aim of the alliance members is to co-operate and to reach the commonly agreed targets.
56. [...].<sup>22</sup> [...].<sup>23</sup> Consequently, the [*traffic steering target*] is [...] a [...] commitment which is fulfilled in practice.

#### Effects of the merger

57. With the merger, the scope of the FreeMove alliance rises significantly while the extent of exchange on the open market will be further limited. Due to the likely switch of O2 to FreeMove an independent contracting partner for the mutual exchange of traffic is eliminated. A subsequent increase in retail international roaming prices as portion of the retail mobile tariffs on the part of the non-FreeMove members is likely. This will have a particularly significant effect in the case of the present merger given that the UK and Germany, according to the investigation carried out by the Commission, are of special importance for international roaming in view of their significance for business customers.
58. O2 will not be any longer an independent alternative provider of wholesale international roaming ready to enter into reciprocal agreements providing for an exchange of traffic as described. Even if O2 does not immediately join FreeMove, it will clearly be subject to the overall roaming business strategy of Telefónica and will therefore act in compliance with Telefónica. The market investigation has shown that, in this respect, O2 has so far mostly been regarded as “independent” since the Starmap alliance is organized only to a lower degree and [...].
59. With 26 million mobile retail customers, O2 is one of the most important “independent” players in the area which is covered by FreeMove and Starmap.<sup>24</sup> Almost all other remaining players outside of the FreeMove alliance, except for Vodafone, are smaller than O2 – only the KPN group is comparable in size and footprint. The quantity of outbound traffic from the FreeMove alliance already to date plays a major role in the overall market given that it applies to the four largest incumbents in the EEA and thereby covers a significant share of total demand.
60. If total demand is regarded in the FreeMove countries in question then it becomes apparent that the total purchases by FreeMove members account for

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<sup>20</sup> [...]

<sup>21</sup> [...]

<sup>22</sup> [...]

<sup>23</sup> [...]

<sup>24</sup> For comparison: Starmap in total has 62.5 million customers (incl. Amena, Cesky and O2).

estimated 21% to 35% with an average value of 31%<sup>25</sup>. This percentage represents the total portion of the market in these countries which is more easily accessible or even already preserved for FreeMove members. This view is appropriate because already now the current shares of steered traffic clearly go beyond the minimum share of [...]. Depending on the respective country, O2's demand would increase this share by between estimated [0-10%] on the basis of the same market volume.

61. On the basis of the above mentioned reciprocity of roaming contracts the significant impediment of competition does, however, not arise from a mere customer foreclosure which results from the fact that purchases are "captured" to an increased extent by the merging parties. Serious doubts concerning a significant impediment of competition result from the fact that this demand will not be available in the future in exchange for the acquisition of international roaming by independent players. Losing O2 as an available transaction partner for reciprocally exchanging international roaming will therefore clearly affect the Starmap / independent mobile network operators. With the elimination of this exchange partner, independent / Starmap providers will be forced to buy international roaming to a larger extent unilaterally.
62. This will represent a clear increase in costs to these independent / Starmap providers in particular with respect to the acquisition of wholesale international roaming in the UK and to some extent in Germany and Ireland, where O2 operates and will not any longer offer reciprocal deals to the same extent as before the merger. In the UK, no alternative provider of international roaming will be left after the merger, since O2 has been the only independent / Starmap player so far (the others are T-Mobile, Orange and Vodafone). In Germany and Ireland, the number of independent / Starmap members will be reduced from two to one. In Germany, E-plus is independent, while T-Mobile and O2 will have to be counted to FreeMove. The fourth provider is Vodafone. In Ireland, only Vodafone and Meteor (independent) are active.
63. Due to the increase in costs to be covered, a subsequent increase in retail international roaming prices for all subscribers of the independent network operators is likely.

#### Conclusion on wholesale international roaming

64. From this can be concluded, that the transaction raises serious doubts with respect to the increased scope of the alliance and the thereby reduced opportunities for independent / Starmap members to exchange traffic in two countries which are particularly important in the roaming segment: Germany and the UK. This will raise rivals' costs on part of the independent / Starmap members in favour of the four large incumbents. The merger would subsequently be likely to lead to an increase in prices for services provided by independent / Starmap operators. Since the only mobile service provider able to compete on an equal foot with FreeMove members would be Vodafone, the

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<sup>25</sup> The market volumes were with one exception taken from information provided by the national regulators. No differentiation has been made between captive and non-captive sales. Since captive sales of Vodafone are therefore still included it is likely that the indicated shares are underestimated to an unknown extent.

Commission has, as this stage, serious doubts on whether competition would be sufficiently guaranteed after the merger.

### *Advanced seamless pan-European mobile telecommunication services for MNCs*

65. During the market investigation the issue was raised that with the elimination of O2 as an independent Starmap member, the Starmap alliance would not survive since it would lose its largest member and focal point.
66. The operation would further strengthen the Freemove alliance, whereas the Starmap alliance would be significantly weakened by losing its largest member. Alliances wanting to respond to the demand of MNCs for pan-European services need to have a sufficiently broad footprint. They moreover need to cover at least some of the largest countries in the EEA. With the merger, Starmap would lose the UK and Germany and would thereby only remain present in one large Member State, namely Italy.<sup>26</sup> During the market investigation it was shown, that in particular the UK and Germany are of significant importance for the demand of MNCs.
67. Whether this change would be sufficient to raise serious doubts as to the impact on competition can be left open, since in any case any such concern would be removed by the remedy which is necessary to remove the Commission's concerns on the wholesale international roaming market.

## **V. PROPOSED REMEDIES**

68. In order to address these serious doubts, the Parties submitted two sets of commitments, the second one of which should only apply if the first one was not considered sufficient to permit Commission clearance in Phase I:
  - **Set 1:** Telefónica committed not to integrate O2 into the FreeMove alliance for a term of 2 years. In order to ensure that the relevant O2 Companies act independently of Telefónica with respect of the relevant wholesale international roaming activities, Telefónica committed to procure that O2 would establish a Roaming Committee which would have responsibility for O2's strategy and day-to-day operational matters in relation to O2's roaming activities in relation to third parties. In order to prevent the communication of commercially sensitive information regarding O2's relevant activities in wholesale international roaming from O2 to Telefónica, Telefónica committed to establish and maintain in force a firewall mechanism.
  - **Set 2:** Telefónica committed to exit the FreeMove alliance without any attempt to re-enter before 1 January 2011 without the Commission's consent.

### **1. Evaluation of Remedy Set 1: O2 remains in Starmap**

69. The market testing and analysis of Set 1 has shown significant concerns with regard to the viability and effectiveness of this remedy to remove the

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<sup>26</sup> Amena is expected to leave Starmap following its recent merger with France Télécom.



Commission's serious doubts. The market test indicated the following problems:

70. The Parties proposed a Roaming Committee which would have responsibility for O2's strategy and day-to-day operational matters in relation to O2's Roaming Activities within the context of the Roaming Business Strategy. This Roaming Business Strategy constitutes the overall guidelines and strategy in relation to the O2 roaming business adopted by O2 after consultation with Telefónica. The market test of the remedy has clearly shown that the market does not expect O2's policy to be really independent of Telefónica if it has to be embedded into this strategic framework. It is, moreover not possible to clearly distinguish between O2's roaming policy which is supposed to be independent and the Roaming Business Strategy as consulted with Telefónica.
71. The market test has moreover confirmed that the proposed firewall cannot be regarded as sufficient to prevent any flow of sensitive business information from O2 to its new parent Telefónica. Telefónica committed in Set 1 that Telefónica would not receive Commercially Sensitive Information other than (i) that connected with assessing compliance with the Roaming Business Strategy and (ii) as necessary for the purposes of corporate governance and other legal or regulatory obligations, including any litigation or other dispute. It is very likely that these exceptions leave sufficient room for a flow of commercially sensitive information towards Telefónica with respect to international roaming which will impede the pursued independence of O2. Apart from this the reporting obligations were considered by the vast majority of respondents as insufficient to effectively monitor compliance.
72. Set 1 does not address the potential serious doubts on the market for pan-European services as described above. On the contrary: with O2 remaining in Starmap and Telefónica in FreeMove an effective link between the two alliances would be constituted and approved. Other links being already in place (Amena, Cesky), this additional connection would be of particular importance, since Set 1 would bind the major member of Starmap O2, which can due to its size be regarded as the focal point of this alliance. The remedy itself therefore might raise additional competition concerns on the market for advanced Pan-European services.
73. The Commission concluded that Set 1 would not be a viable remedy to remove the serious doubts concerning this transaction. Set 1 by itself would clearly not allow the Commission to clear the case in phase one. Consequently, Set 2 of the proposed remedies applies.

## **2. Evaluation of Remedy Set 2: Telefónica exits FreeMove**

74. Remedy Set 2 foresees that Telefónica will exit FreeMove and not seek re-entry before 2011. Formal member of FreeMove is not Telefónica but its fully controlled subsidiary Telefónica Móviles S.A.. In the following, reference is made only to Telefónica covering Telefónica Móviles S.A..
75. Telefónica will serve notice of its withdrawal from FreeMove by [...]. Telefónica will formally withdraw from FreeMove as quickly as reasonably practicable and in any event by 30 September 2006. Telefónica will not re-enter FreeMove before 1 January 2011. If an earlier re-entry is sought, the

Commission's prior approval needs to be obtained. Such approval may be granted in particular if there has been a material change in market circumstances.

76. Telefónica commits that, from the completion of the merger until formal withdrawal has taken place, Telefónica will not attend any meetings of FreeMove relating to the FreeMove roaming projects and will not receive any information in this respect. This does not affect Telefónica's obligations under agreements to which it is already a party or from entering into new agreements in the normal course of business with any FreeMove Member.
77. It is evident that Set 2 clearly removes all serious doubts with respect to the transaction as described above. With Set 2 it is ensured that the number of providers of wholesale international roaming from different alliances as prevailing before the merger is maintained in the UK, Ireland and Germany. A sufficient amount of outbound wholesale international roaming traffic will be allocated outside of the FreeMove rules and will thereby be accessible by independents and Starmap members.
78. With respect to potential serious doubts on the pan-European market, this remedy moreover clearly removes the link between the two alliances FreeMove and Starmap which would be established after the merger. Thereby the independence of these competitors on the market for pan-European services is secured. Starmap would not automatically be marginalized. The market structure will moreover allow for a third large competitor on the market for pan-European services either in the form of Starmap or any other new constellation. The potential serious doubts would therefore be completely removed with this remedy.

### **3. Conclusion on the remedies**

79. The Commission has found that remedy Set 1 does not remove the serious doubts as was confirmed by the market testing. The Commission considers that remedy Set 2 is sufficient to eliminate the serious doubts as to the compatibility of the transaction with the Common Market.

## **VI. CONCLUSION**

80. The Commission has concluded that the remedies submitted by the Parties are sufficient to address the serious doubts raised by the concentration. Accordingly, subject to the full compliance with the commitments submitted by the notifying party, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)b and Article 6(2) of Council Regulation (EC) No 139/2004.
81. The Commission underlines that the complete withdrawal of Telefónica from FreeMove by 30 September 2006 the latest is a condition to the clearance of the proposed transaction. In addition, it is a condition to the clearance of the proposed transaction that Telefónica will not re-enter FreeMove before 1 January 2011 without the Commission's prior approval. Telefónica will – as an obligation to the proposed transaction - serve notice by [...].

82. The detailed text of this undertaking is annexed to this decision. The full text of the annexed undertaking forms an integral part to this decision.

For the Commission  
signed  
Charlie McCREEVY  
Member of the Commission

**NON-CONFIDENTIAL VERSION**

**CASE COMP/M.4035**

**TELEFÓNICA/O2**

**COMMITMENTS PURSUANT TO ARTICLE 6(2) OF  
REGULATION NO 139/2004**

**By Hand**

European Commission  
DG Competition  
Rue Joseph II 70 Jozef-II straat  
B-1000 BRUSSELS

**CASE COMP/M.4035 – TELEFÓNICA/O2****Commitments to the European Commission Pursuant to Article 6(2) of Council Regulation No 139/2004**

Pursuant to Article 6(2) of Council Regulation 139/2004 (the "**Merger Regulation**"), TELEFÓNICA, S.A. ("**TELEFÓNICA**") and O2 plc ("**O2**") in the context of the concentration between TELEFÓNICA and O2 (the "**concentration**") hereby give the following commitments (the "**Commitments**") to the European Commission (the "**Commission**") in order to enable the Commission to declare the concentration compatible with the common market by its decision pursuant to Article 6(1)(b) of the Merger Regulation (the "Commission Decision").

The concentration consists of the acquisition by way of public offer by TELEFÓNICA of 100% of the issued share capital of O2 (the "**Transaction**"). The Transaction is at present being reviewed by the Competition Directorate General of the Commission. In order to enable the Commission to declare the Transaction compatible with the common market by a decision pursuant to Article 6(1)(b) of the Merger Regulation, it may be necessary for TELEFÓNICA to give certain undertakings to the Commission pursuant to Article 6(2).

In particular, the Commission has at this stage been unable to discount fully the possibility that as a result of the possibility of O2 being integrated into the FreeMove alliance there may be an adverse impact on the position of independent mobile telecommunications operators in those countries where FreeMove Members (as defined below), other than TELEFÓNICA, or their Qualifying Subsidiaries (as defined below) operate. As a result, TELEFÓNICA, in order to facilitate the clearance of the Transaction in Phase I, provides an undertaking that it will exit from the FreeMove agreements.

To be able to offer the appropriate remedial undertakings to the Commission, it is necessary for TELEFÓNICA to enter into these Commitments.

As provided below, these Commitments shall take effect from the date of the adoption of the Commission Decision as defined below. These Commitments shall be null and void if the Transaction is not completed and/or if the Commission Decision is not issued.

This text shall be interpreted in the light of the Commission Decision to the extent that the Commitments are attached as conditions and obligations, in the general framework of Community law, in particular in the light of the Merger Regulation, and by reference to the Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

## DEFINITIONS

The words and phrases set out below have the following meanings in this document:

**"Commission Decision"** means the European Commission's Decision in Case COMP/M.4035 – TELEFÓNICA/O2 declaring the concentration between TELEFÓNICA and O2 compatible with the common market pursuant to Article 6(1)(b) of the Merger Regulation.

**"Completion"** means the date the offer for O2 by TELEFÓNICA becomes or is declared wholly unconditional in accordance with its terms.

**"FreeMove"** means the FreeMove alliance as established pursuant to the FreeMove Agreements entered into by T-Mobile International AG & Co. KG, Telefónica Móviles S.A., Telecom Italia Mobiles s.p.a. and Orange S.A..

**"FreeMove Member"** means a member of FreeMove and any of its Qualifying Subsidiaries.

**"FreeMove Agreements"** means the Amended and Restated Co-operation Agreement, as amended from time to time, dated [CONFIDENTIAL] and all ancillary agreements, as amended from time to time.

**"O2 Company"** means any of O2 (UK) Limited, O2 (Germany) GmbH & Co. OHG, O2 Communications (Ireland) Limited and their successors, and **"O2 Companies"** shall be construed accordingly.

**"Qualifying Subsidiary"** means an operating subsidiary of a FreeMove Member that is identified as being a qualifying affiliate under the FreeMove Agreements.

**"TEM"** means Telefónica Móviles S.A..

## Section A. **Withdrawal from FreeMove**

A1. TELEFÓNICA commits to enter into a commitment in the form set out in Annex A that it will procure that TEM withdraws from FreeMove.

A2. TELEFÓNICA commits further not to rejoin FreeMove after such withdrawal for the period ending on 01 January 2011 without the Commission's prior consent, without prejudice to its right to seek a review of these Commitments under section C2 below.

## Section B. **Reporting and monitoring**

### Commitment to provide information to the Commission

B1. TELEFÓNICA shall notify the Commission promptly once Completion has taken place.

B2. TELEFÓNICA shall submit a written report to the Commission within 2 weeks of notice of termination being given in accordance with Annex A and within 2 weeks of TEM's formal withdrawal from the FreeMove Agreements becoming effective.

B3. TELEFÓNICA shall provide and shall cause its advisors to provide the Commission with all such co-operation, assistance and information as the Commission may require to perform its functions within the framework of the present procedure.

## Section C. **Review**

C1. The Commission may, where appropriate, in response to a request from TELEFÓNICA, showing good cause, grant an extension of the time periods foreseen in the Commitments. TELEFÓNICA shall apply for such extension no later than 2 weeks in advance of the relevant date, unless it is not possible to do so, in which case it shall apply for such extension without undue delay.

C2. The Commission may, where appropriate, in response to a request from TELEFÓNICA, showing good cause, modify, substitute or release one or more of the undertakings in these Commitments in the event that the Commission concludes that such undertaking(s) is/are no longer necessary to render the proposed concentration compatible with the common market and, in particular, where there has been a material change in the market circumstances or a material change in the membership of FreeMove or in the FreeMove Agreements.

## ANNEX A

### Commitment to withdraw from the FreeMove Agreements

1. TELEFÓNICA shall procure that TEM shall withdraw completely from the FreeMove Agreements, in accordance with their terms, as quickly as reasonably practicable and in any event by 30 September 2006.
2. TELEFÓNICA shall procure that TEM serves notice by **[CONFIDENTIAL]** to terminate its membership of FreeMove and participation in the FreeMove Agreements, in accordance with their terms.
3. Without prejudice to paragraph 4 below, TELEFÓNICA commits to procure that, from Completion until formal withdrawal has taken place, TEM will not attend any meetings of FreeMove relating to the FreeMove roaming projects. Furthermore, TELEFÓNICA will procure that TEM will not receive information related to such meetings or new projects.
4. Nothing in the terms of these Commitments shall prevent TELEFÓNICA, TEM, O2 or any of TELEFÓNICA's subsidiaries from exercising its rights and carrying out its obligations under agreements to which it is already a party or from entering into new agreements in the normal course of business with any FreeMove Member.
5. Further, for the avoidance of doubt, these Commitments shall not be deemed to have been breached if TEM is not able to withdraw from FreeMove due to circumstances entirely outside of TEM's or TELEFÓNICA's control and in such circumstances TELEFÓNICA shall without undue delay contact the Commission pursuant to section C2 above to discuss the appropriate action.