



Proposed acquisition by Cable and Wireless of the outstanding shares in Thus Group plc

ME/3752/08

The OFT's decision on reference under section 33(1) given on 12 September 2008. Full text of decision published 23 September 2008.

Please note that square brackets indicate figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Cable & Wireless plc** (C&W) is an international communications provider (CP) active in the UK supply to business customers of fixed line telecommunications and related services.
2. **Thus Group plc** (Thus), headquartered in Glasgow, is a UK-focused CP active in the supply principally to business customers of fixed line telecommunications and related services.¹ In the previous financial year ending 31 March 2008, Thus' turnover amounted to around £575 million.

TRANSACTION

3. On 30 June 2008, C&W announced that it had acquired a 29.9 per cent shareholding in Thus and that Thus' directors had agreed to put to its shareholders C&W's public offer for the remaining shares. The administrative target date for the OFT's decision on reference is 12 September 2008.

JURISDICTION

4. As a result of these transactions, C&W and Thus would cease to be distinct. Given that Thus' UK turnover exceeds £70 million, the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.²

MARKET DEFINITION

PRODUCT SCOPE

Hosting services

5. C&W and Thus overlap in, amongst other things, the provision of hosting infrastructure and services that allow organisations to deliver content to and facilitate business transactions on networks such as the Internet without having to own and manage any necessary machinery and specialised telecoms. The supply of such services includes performance monitoring, backup, security and various levels of technical support.

Telecommunications (telecoms)

6. The parties also overlap in the supply both of the connective infrastructure and of the services that provide for long and short distance telecommunication of voice and data.
7. BT³ is by far still the largest telecoms provider in the UK: a position due to having been the erstwhile national state-owned supplier prior to the break up in 1982 of its monopoly and to its subsequent privatisation in 1984.

¹ Thus began operating in 1994 as Scottish Telecom, the telecommunications arm of the privatised energy company, Scottish Power.

² The OFT has conducted its analysis on the basis of the anticipated acquisition by C&W of the outstanding Thus shares. It considered that it did not need to assess whether the completed acquisition by C&W of 29.9 per cent of the issued share capital of Thus constituted an acquisition of material influence, or the competition effects of such acquisition, on the basis that this completed acquisition is not capable of raising any additional concerns not considered as part of the anticipated acquisition of the outstanding Thus shares.

³ The BT Group plc – formerly British Telecom plc.

8. C&W, Thus and other communications providers (CPs) in the telecoms industry have since built and operate their own proprietary networks of fixed line telecoms infrastructure. These physical networks have been laid out in such a way as to be accessible to and to connect principally urban areas of high density population within the UK. Although limited in geographic coverage, they are nonetheless capable of meeting, on competitive terms, with one or more parts of a business customer's total telecoms requirement.
9. On the basis of their installations of fixed line telecoms infrastructure, the principal supply side overlaps between the parties comprise:
 - (1) the retail of telecoms directly to customers, and
 - (2) the wholesale supply to other CPs, on mutually agreed terms and conditions, of the connectivity that the parties have built into each of their telecoms networks ('wholesale carrier services').
10. At both retail and wholesale levels, no CP is able to offer comprehensive national and international telecoms coverage by itself without obtaining, from within the wider wholesale segment on the basis of paragraph 9(2) above, use of the fixed cable infrastructures owned by BT and by all other CPs in the UK – and a requisite number of CPs abroad.
11. Therefore, both parties and all other CPs in the UK also overlap in the heavy demand for the wholesale of telecoms from BT and – and somewhat lighter demand for the wholesale of telecoms from competing CPs.
12. Since the Electronic Communications Framework Directive⁴ was implemented as law in the UK in the form of the Communications Act 2003, there has been a requirement that the amount of regulation, and its focus within the UK telecoms industry, be determined by the results of market reviews carried out – with reference to European Commission guidelines – by Ofcom. The ambit of such reviews is not to segment the telecoms industry into economic markets as is the case for more 'standard' competition assessment. Rather, they are undertaken with the principal

⁴ Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services.

objective of identifying segments in the overall telecoms industry in which BT continues to have 'significant market power' (SMP) notwithstanding the extent and the impact of the market liberalisation that has taken place thus far.

13. Ofcom typically imposes the following obligations on telecoms suppliers with SMP (BT in the vast majority of cases):
 - (1) non-discrimination: a general obligation not to discriminate against any individual or group by putting its competitors at a competitive disadvantage, either to BT itself or to other competitors
 - (2) transparency: an obligation to publish information explaining how charges are set and to publish reference offers including details on charges, payments and service levels
 - (3) network access: an obligation to provide competitors and other parties with fair and reasonable access to network and leased lines where a party presents a reasonable request, and
 - (4) price control: Ofcom can specify how and at what level prices should be set.
14. Ofcom is also currently in the process of reviewing the regulatory framework required in the business communications industry going forward from 2009. This 'Business Connectivity Market Review' (BCMR) has progressed to the extent that responses to a market consultation have already been submitted and are now being analysed.⁵
15. Taking account both of Ofcom's current approach to the SMP segmentation of the overall UK telecoms industry and of the approach taken by the OFT in the C&W/Chelys⁶ decision (in which the OFT adopted Ofcom's SMP segmentation as a starting point for its competition analysis), C&W proposes, and a considerable majority of customers and competitors agree, that the segmentations in Table 1 (voice telecoms) and Table 2 (data

⁵ www.ofcom.org.uk/consult/condocs/bcmr

⁶ Cable & Wireless/Chelys – 2005.

telecoms) are a reasonable basis on which to begin to assess the competitive impact of the horizontal effects of the merger between the parties in the present case.⁷

Table 1: Segmentation in voice telecoms

Voice telecoms		
Segment	Retail/ Wholesale	Summary description
Access services	Retail	Provision of access to the public voice telephony network.
Business voice calls	Retail	Provision of business voice calls over interconnected fixed line telecoms networks in which BT, as the incumbent operator, has by far the largest presence.
International interconnect	Wholesale	Provision for the automated transfer of voice calls made by a business customer from a specific CP in one country to a CP in another country.
National interconnect	Wholesale	Provision for the automated transfer of voice calls between one proprietary network in the UK to another proprietary network in the UK.
Indirect Access (IDA) & Carrier pre-selection (CPS)	Wholesale	Provision for business customer to choose, for its requirement for voice telecoms, a proprietary network supplier who has purchased a package (including terms and conditions etc) of access to the larger BT network and in some cases beyond to CPs abroad.
Telebusiness	Retail	Provision of calls that are routed to 'call centres' in the UK and worldwide to be facilitated by the use of 'non geographic numbers' that are hosted by proprietary networks.

⁷ The OFT considers that its analysis on this case should also have a focus on the impact of the merger on 'business data communications' and on 'lease of dark fibre' – neither segment being the subject of regulation by Ofcom.

Table 2: Segmentation in data telecoms

Data telecoms		
Segment	Retail/ Wholesale	Summary description
Business data communications	Retail	Provision of high bandwidth, high performing, resilient and secure telecommunications of often large quantities and of business data.
Leased lines	(1) Retail (2) Wholesale	Provision of telecoms lines permanently connected between sites and dedicated to the exclusive use of the business customer. Ofcom's regulatory construct currently subdivides the supply of leased lines into categories according to differing bandwidth capacities ⁸ and other technical specifications ⁹ .
Dial-up Internet access	Wholesale	Provision for customer access to the Internet using dial-up from residential homes. This now represents only a small and declining proportion of the total of Internet connectivity.
Dedicated Internet access	(1) Retail (2) Wholesale	Provision for broadband Internet connectivity permanently connected between sites and dedicated to the customer's exclusive use.

GEOGRAPHIC SCOPE

16. Consistent with the OFT's decision in C&W/Chelys and with the regulatory approach adopted by Ofcom, the parties propose that the relevant geographic frame of reference is national in geographic scope. For the purposes of the current assessment, the OFT considers this to be a reasonable starting point, albeit that for some segments (for example, leased lines), distinctions apply in the Hull area, where the telecoms incumbent is Kingston Communications) and in the Central and East London area ('CELA') where the competitive conditions are substantially different from those prevailing in the rest of the UK. To the extent these

⁸ (1) Low, (2) high and (3) very high bandwidths.

⁹ (1) Traditional interface symmetric broadband origination (TISBO) and (2) Alternative interface symmetric broadband origination (AISBO).

differences could have a material impact on the competitive assessment, they are discussed further below in the Horizontal Issues section.

HORIZONTAL ISSUES

Hosting services

17. The leading players in the provision of hosting services are large outsourcing companies such as IBM and EDS. In the absence of concerns from third parties and the increment to C&W's share of supply being very small, the OFT gives no further consideration to this segment in the context of this assessment.

TELECOMS

Voice telecoms

18. Third party comment unanimously supports other evidence from the parties (including bidding data) and from Ofcom that, not least given BT's significant market power across all the relevant segments (see Table 1) in the overall voice telecoms sector, the merger will have no adverse impact on the existing market structure – which provides for interplay in all the relevant segments, between regulation by Ofcom and the availability of several competitors between whom customers can easily and readily do switch at little cost.
19. The majority of customers submitted to the OFT that the merger between C&W and Thus would result in a wider range of services being available in the UK and in the creation of a more effective competitor to BT.
20. Given these factors, the OFT considers that the merger will not lead to a substantial lessening of competition in the supply of voice telecoms.

Data telecoms

21. The OFT's assessment has first focussed on three principal areas of *prima facie* concern in data telecoms, namely:
 - (1) business data communications, of the specific data segments set out in Table 2, this was the only one that was

the subject of any adverse comment from two of the total of 28 customers who engaged with the OFT's enquiries

- (2) leased lines, the OFT considered that a cautious assessment was warranted of the impact of the apparent increases in already high levels of concentration amongst the suppliers of certain of Ofcom's categories of leased lines dedicated to data communication, and
- (3) dark fibre¹⁰, separately from the SMP segmentation constructs applied by Ofcom, consideration was given to a body of third party comment that raised concerns for the impact of the merger on the wholesale supply of this type of telecoms connectivity.

Business data communications

- 22. The concerns in this segment were raised by two customers (both large financial institutions) pointing to the loss of Thus as an independent and reputable CP able to bid credibly and competitively in response to tenders for the supply of high performance, resilient and secure business connectivity – ostensibly reducing the number of such suppliers to two: BT and C&W. Whereas one of these customers also prefaced such concerns with the acknowledgement of the potential scope for the merger to lead to increased competitive efficiency between the two remaining players, the other submitted that, due to the nature of its procurement model, it could foresee no such efficiencies.
- 23. Following the receipt of such adverse comment, the OFT made further consultation with similar sized customers in the financial sector – all of whom acknowledged the potential for C&W to become a stronger and more effective competitor in relation to BT.
- 24. The OFT considers that the available evidence (including bidding data provided by the parties) indicates that:

¹⁰ This is very high bandwidth fibre optic cable that has already been built out, point to point, at various geographic locations within the UK but which remains so far remains to be put to any use ('lit') by being incorporated into its owner's (or any other CP's) telecoms network.

- (1) Thus' share of the supply to the overall business communications segment is small (between five and ten per cent)
- (2) the parties have previously competed against each other only to a limited extent, and
- (3) competitive constraint is posed, even in the financial sector in which two customers have raised concerns, by other CPs such as Global Crossing and Virgin Media.

Leased lines

- 25. For the purposes of this decision, the OFT limited its assessment of the overall leased line segment to the three sub-segments specifically where both C&W and Thus are named by Ofcom in its Business Connectivity Market Review (see paragraph 14) on the basis of material overlap between them. These comprise leased lines of the following specifications:
 - (1) wholesale high bandwidth in the UK (excluding CELA and Hull – see paragraph 16)
 - (2) wholesale high bandwidth in CELA, and
 - (3) retail of very high bandwidth in the UK excluding the Hull area.
- 26. The OFT considers that the absence of third party concerns for the supply of leased lines supports the available evidence that the merger will not lead to a substantial lessening of competition in any of the above sub-segments. Despite the number of competitors with a share of supply in excess of three per cent being reduced – four to three in the case of the segment in paragraph 25(1) above and five to four in the segments in paragraph 25(2) and (3) – the available evidence indicates that these segments are highly contestable and that the award of just one major contract is capable of having a considerable impact on shares of supply. Other players include BT, Virgin Media, COLT, Kingston, Verizon and Global Crossing. Moreover, in the case of the segments in paragraphs 25(1) and (3), there is a high degree of complementarity (as opposed to substitutability) between the

merging parties in that Thus' supply of leased lines is focused on Scotland whereas C&W's is focused on the rest of the UK.

27. In light of such evidence and of the lack of customer concern, the OFT considers that the merger will not lead to a realistic prospect of a substantial lessening of competition in the supply of leased lines.

Dark fibre

28. Concerns were raised that some CPs, who currently look to Thus as an actual or potential supplier of dark fibre – a segment not regulated by Ofcom – will be foreclosed from leasing such fibre from Thus after the merger. Such foreclosure would be on the basis of a perception that it is C&W's policy not to offer its own dark fibre to competing CPs and that a similar policy will be imposed on the supply of Thus' dark fibre post merger.
29. In response to this concern, C&W submitted that its business policy was consistent with that of Thus and of other telecoms providers and comprised making the most profitable use of its assets. Consequently, prior to the merger, any decision on the part of either C&W or Thus to grant access to dark fibre was on bespoke terms and conditions and depended on the individual circumstances of the transaction by assessing both commercial viability and opportunity costs. C&W asserted that such profit maximising strategies will continue to be implemented post merger. In addition, C&W further submitted that there is a large number of suppliers (for example, GEO, Neos Networks, NTL/Telewest, Global Crossing) who generally provide core network dark fibre in the UK, with the consequence that Thus' actual and potential customers will, going forward, retain a wide range of options other than C&W (should C&W in certain circumstances decide not to supply).
30. In light of such evidence and of the lack of concern expressed by a substantial majority of customers, the OFT considers that the merger will not lead to a substantial lessening of competition in the UK supply of dark fibre.

Conclusion on data telecoms

31. In all the segments listed in Table 2, and also in the supply of dark fibre, a substantial lack of concern from a majority of customers underpins other evidence (including bidding data) provided to the OFT by the parties and by Ofcom that, not least given BT's significant market power across all the relevant segments in the overall data telecoms sector, the merger will have no adverse impact on the existing market structure – which provides for interplay in all the relevant segments, between regulation by Ofcom and the availability of several competitors between whom customers can easily and readily do switch at little cost.

VERTICAL ISSUES

32. The vertical relationship between the upstream wholesale supply and the downstream retail supply of telecoms connectivity is a significant feature of this industry. BT is by far the largest, but is not the only supplier of wholesale telecoms.
33. Sales by C&W of connectivity to Thus account for [x] per cent of C&W's revenue in the wholesale market. Sales to C&W of Thus connectivity account for only [x] per cent of Thus' revenue in this market. The parties' respective sales of connectivity to other third parties in the wholesale segment are considerably greater. The OFT considers therefore that there will be no post-merger incentives to foreclose downstream competitors in the retail segment. Similarly, given the existence of other competitors in the wholesale segment (including the dominant supplier BT) the OFT is also of the view that the merger will not facilitate any other foreclosure strategy and that no other competition concerns arise as a result of vertical integration between the parties.

THIRD PARTY VIEWS

34. Comments were received from a total of 39 third parties, of whom 28 were customers.
35. The OFT has also consulted Ofcom, who are of the view that the merger raises no competition concerns.

36. Two financial institutions expressed concerns for the possibility of adverse impact on competition, as a result of the loss of Thus as an independent competitor in the supply of business data communications. These concerns have been addressed in the context of this decision.
37. The vast majority of third parties expressed no concerns with regard to the merger. Several were of the view that the acquisition of Thus would afford C&W greater geographic coverage and consequently reduce its requirement at both wholesale and retail levels to incur costs in integrating connectivity from other CPs. The same third parties discussed the potential for the integration of the two networks to bring about efficiencies that would result in customer benefits as a result of increased rivalry to BT. The OFT's assessment of such arguments on the part of customers for efficiency benefits is set out below.

Efficiency arguments

38. The OFT notes that the reach of C&W's proprietary telecoms network will be extended as a result of its acquisition of Thus. According to data provided by Ofcom, around 50 per cent of Thus' proprietary network is complementary to C&W's network.
39. In order to provide their customers with national and international telecoms coverage, C&W and Thus rely on other CPs – principally the dominant supplier BT – to provide the physical connectivity necessary for such national and global reach. At present, both parties are currently obliged to incur costs handing over part of their respective customers' data and voice traffic to BT in order to establish connectivity with the intended recipients. The costs that C&W incurs in making use of other CPs' networks are partly functions of (in the case of BT) regulation, and (in all cases) the distance over which C&W's customers' voice and data signals are carried back and forth on one (or more) rival CP's infrastructure.
40. A large body of third party comment supports C&W's proposition that efficiencies accrue to the fact that more traffic will be carried for longer on the parties' combined network. In particular, post merger, C&W will pay less to BT as a result of being able to use its proprietary infrastructure at the retail level to deliver more of its own (and Thus') customers' telecoms traffic.

41. Additionally, third parties commented to the OFT that the network effects attributable to the extended reach both of C&W's connective infrastructure on the one hand, and of the increment in its resident customer bases on the other, are capable of generating additional revenue for C&W by making of it a more effective post-merger competitor to BT in the wholesale supplier of telecoms connectivity.
42. While the OFT considers there is some merit in the parties' efficiencies claims, it did not need to conclude on either the magnitude of future cost savings or additional revenues, or to substantiate the extent to which the benefits that arise from ostensibly rivalry-enhancing efficiencies will be passed on to C&W's customers at both the retail and the wholesale levels given that the transaction does not raise competition concerns.
43. In light of the available evidence that the merger will not lead to a substantial lessening of competition, however, the OFT considers that is not necessary to reach any conclusion on the merits or otherwise of the arguments for the merger generating rivalry enhancing efficiencies.

ASSESSMENT

44. C&W and Thus overlap principally in the provision in the UK of voice and data telecommunications: an industry in which the previous monopoly supplier, BT, continues to have significant market power and which is therefore subject to regulation by Ofcom.
45. Comments on the proposed merger were received from a total of 39 third parties, of whom 28 were customers. Given the interplay between regulation and the post merger constraint posed by competitors, the lack of concern for the merger's impact on competition was unanimous in the voice segment. Whilst a minority of two customers expressed concerns in the data segment, the OFT considers that the evidence available both from Ofcom and from the parties (including bidding data) underpins comments received from the overwhelming majority of customers in the data segment who, also on the basis of the regulatory regime and of the availability of post merger competitive constraint, were unconcerned.
46. Having assessed the evidence, the unique attributes of both the merger and of the industry, the OFT considers that there is also merit in the

submissions made by the parties and by third parties on the potential for rivalry-enhancing efficiencies resulting from the merger. However, the OFT did not need to conclude on this issue given that the transaction does not raise competition concerns.

47. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

48. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.