

ANTICIPATED ACQUISITION BY BT GROUP PLC OF EE LIMITED

Statement of issues

17 July 2015

The reference

1. On 9 June 2015, the Competition and Markets Authority (CMA), in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act), referred¹ the anticipated acquisition by BT Group plc (BT) of EE Limited (EE) (the merger) for further investigation and report by a group of CMA panel members.
2. The CMA must decide:
 - (a) whether arrangements are in progress which, if carried into effect, will result in the creation of a relevant merger situation; and
 - (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.²
3. In this issues statement, we set out the main issues we are likely to consider in reaching our decision, having had regard to the evidence gathered to date including evidence set out in the phase 1 decision to refer the acquisition of EE by BT for further investigation (the reference decision).³ This does not preclude the consideration of any other issues which may be identified during the course of our investigation.
4. Throughout this issues statement, where appropriate, we refer to BT and EE collectively as ‘the parties’ and the anticipated combined organisation as ‘the merged entity’.

¹ The reference was made under the CMA fast-track procedure. See [Mergers: Guidance on the CMA's jurisdiction and procedure \(CMA2\)](#), paragraphs 6.61 to 6.65

² Section 36(1) of the Act.

³ See the [reference decision](#) on the case page.

Background

5. BT is a UK-based communications services company, active in the provision of fixed-line and mobile communications services, broadband, TV products and services, and managed networked IT services. BT provides, on a wholesale basis, services to Mobile Network Operators (MNOs) that enable these companies to connect their 'radio base stations' to their core network. These services are known as 'mobile backhaul services'.
6. BT is the largest provider of fixed network services in the UK. It is subject to regulation by Ofcom across a number of its functions and particularly in relation to its Openreach⁴ division.
7. EE is an MNO operating exclusively in the UK, running the EE, Orange and T-Mobile brands. It offers mobile services (consisting of voice, messaging and data services), fixed voice and broadband services and pay TV services to retail customers. EE also provides wholesale access to its mobile network, which allows other companies to offer retail mobile services.
8. EE was established as a 50:50 joint venture between Orange S.A. (Orange) and Deutsche Telekom AG (DT), following the merger of T-Mobile UK and Orange UK on 1 April 2010. EE has a 50% share in Mobile Broadband Network Limited (MBNL), which is a network sharing joint venture with Hutchison 3G UK Limited (H3G).
9. More information on the parties can be found in paragraphs 15 to 19 of the reference decision.⁵
10. BT, DT and Orange signed a sale and purchase agreement for BT's acquisition of the entire issued share capital of EE on 5 February 2015 for a purchase price of £12.5 billion.⁶
11. Of relevance to the CMA inquiry into the merger is a parallel telecoms transaction subject to merger control clearance by the European Commission (Commission), involving the proposed acquisition of Telefonica UK Limited (O2) by Hutchison Whampoa Limited (parent company to H3G). O2 and H3G are both major players in the UK telecoms market, and we will consider the

⁴ Openreach is functionally separate from BT's downstream wholesale and retail activities, in accordance with undertakings offered to Ofcom in 2005 in lieu of a market investigation reference to the Competition Commission

⁵ See the [reference decision](#) on the case page.

⁶ As set out at paragraph 27 of the reference decision, at phase 1 the CMA did not consider that the acquisition by DT and Orange of their proposed shareholdings in BT (and in the case of DT) its board appointment give rise to material influence over BT. Accordingly, at phase 1 the CMA did not consider that these interests (either separately or together) give rise to one or more relevant merger situations and these interests did not form part of the reference to phase 2 and are not considered in this issues statement.

potential implications of the proposed merger and the Commission's investigation for the competitive conditions in the UK and in particular the counterfactual (see paragraphs 37 to 40).

Market definition

12. A market definition is helpful to identify, in a systematic way, the immediate competitive constraints facing the merged entity. Market definition is a useful analytical tool, but not an end in itself, and identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of the CMA's analysis of the competitive effects of the merger in any mechanistic way. In assessing whether a merger may give rise to an SLC, the CMA may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.⁷
13. As described later in this issues statement, we have identified potential theories of harm in relation to five areas of the parties' operations: (a) retail mobile; (b) wholesale mobile; (c) mobile backhaul; (d) wholesale broadband; and (e) retail broadband. We will investigate the appropriate frame of reference in which to carry out the competitive assessment in each of these areas.
14. The parties overlap at both a horizontal and vertical level. Specific overlaps will be discussed for each area of the parties' operations.
15. Unless otherwise specified below, we consider that the appropriate geographic frame of reference for each product market should be the UK in its entirety.

Retail mobile

16. The parties overlap at a horizontal level in the supply of retail mobile services. The parties also overlap at a horizontal level in other segments, which may also be relevant to retail mobile competition when considering bundles, including retail fixed voice services, retail fixed broadband services, retail pay TV services and retail fixed bundles (incorporating, for example, fixed broadband and pay-TV).
17. The parties submitted that the relevant product scope for considering the retail mobile market should be the market for retail mobile telecommunications

⁷ [Merger Assessment Guidelines \(CC2/OFT 1254\)](#), September 2010, paragraph 5.2.2.

services, which is the market on which MNOs and MVNOs⁸ sell voice and data services to end customers via a mobile network.

18. We will investigate the extent to which different aspects of retail mobile can be aggregated on the basis of demand-side and/or supply-side substitution. This may include:
- (a) the extent to which business and domestic customers should be considered separately;
 - (b) the extent to which there may be sub-markets for 4G mobile services or for users consuming high levels of data;
 - (c) the extent to which the market for mobile/fixed bundles⁹ can be considered as a separate market to unbundled offers,¹⁰ and within a bundled segment which includes pay-TV, whether there are further distinctions based on the TV services offered; and
 - (d) the extent to which there may be other markets which should be considered separately (for example, SIM-only).

Wholesale mobile services

19. The four MNOs in the UK (EE, H3G, O2 and Vodafone) currently provide wholesale access and call origination services to MVNOs. This allows companies that do not have their own mobile network infrastructure or hold spectrum to supply retail mobile services to their customers by using an MNO's infrastructure.
20. There are vertical links between the parties in the provision of wholesale mobile services in that EE provides wholesale access and call origination services to BT (through their MVNO arrangement), as well as to other MVNOs.
21. The parties submitted that there was a single wholesale market for access and call origination on public mobile telephone networks, and that there was no plausible narrower product market definition. They also submitted that the

⁸ Mobile Virtual Network Operator – a company that provides mobile telephony services to its customers by purchasing wholesale mobile services from an MNO.

⁹ Mobile/fixed bundles are where retail mobile services are sold together with one or more fixed services, such as fixed voice, broadband and/or pay-TV

¹⁰ For example, retail mobile services sold on a standalone basis.

appropriate geographic scope of the frame of reference for the provision of wholesale access and call origination services to MVNOs is the UK.¹¹

22. For ease of reference in this issues statement, we refer to the supply of wholesale access and call origination services as the supply of 'wholesale mobile services'.
23. We will investigate the extent to which different aspects of wholesale mobile services to MVNOs can be aggregated on the basis of demand-side and/or supply-side substitution. In particular we may consider:
 - (a) the extent to which the different types of MVNOs¹² may represent distinct customer segments; and
 - (b) the extent to which there may be different markets for different technologies (for example 2G, 3G, 4G and other).

Mobile backhaul services

24. Mobile backhaul is the network connectivity between an MNO's radio base station and its core network. It can be provided through copper, microwave and/or fibre.
25. There is a vertical link between the parties in that BT provides mobile backhaul services to EE, as well as to the other MNOs.
26. The parties submitted that there was no separate market for mobile backhaul, and that it should be considered as part of a broader leased lines market. They also submitted that the geographic scope of the frame of reference of mobile backhaul should be the UK as a whole.
27. We will investigate the extent to which different aspects of leased lines can be aggregated on the basis of demand-side and/or supply-side substitution. In particular we may consider:
 - (a) the extent to which mobile backhaul is a separate market, or part of a wider market for leased lines;

¹¹ See the [reference decision](#), paragraphs 62 and 65, and the [parties' phase 2 initial submissions](#), paragraphs 2.1 to 2.3.

¹² For example, MVNOs may be 'light' or 'full' (depending on their infrastructure), may offer retail mobile on a standalone basis or as part of a fixed/mobile bundle, or may target specific customer segments. See the [reference decision](#), paragraphs 60 to 61 for more details of different types of MVNOs.

- (b) the extent to which the supply of fibre mobile backhaul, copper mobile backhaul and microwave mobile backhaul should be considered as separate markets;
- (c) the extent to which the supply of mobile backhaul using managed, unmanaged and dark fibre networks should be considered as separate markets; and
- (d) the extent to which competition for the supply of mobile backhaul is subject to regional differences within the UK.¹³

Wholesale broadband

- 28. There are vertical links between the parties in wholesale broadband in that BT provides a number of wholesale fixed services to EE and other MNOs and communication providers (CPs) that are used for the provision of both retail mobile services and retail fixed services.
- 29. We will investigate the extent to which wholesale broadband can be aggregated on the basis of demand-side and/or supply-side substitution. In particular we may consider the extent to which the different wholesale broadband inputs (WBA, VULA and LLU)¹⁴ should be considered as separate markets.

Retail broadband

- 30. In order to provide fixed broadband services to their customers, retail operators must connect their core network with the customers' premises. This can be achieved by:
 - using the provider's own access network;
 - unbundling BT's local exchanges and using Openreach¹⁵ for the connection between the local exchanges and the customer's premises;or

¹³ For example, as set out at footnote 42 of the phase 1 decision, the CMA notes that Ofcom, as part of its periodic review, has identified two regional markets within the UK where BT does not have significant market power (SMP) in the supply of mobile backhaul services, namely: (i) the Hull area for all wholesale leased lines; and (ii) the western, eastern and central London area including Slough for medium bandwidth and high bandwidth TISBO lines and for MISBO.

¹⁴ Wholesale Broadband Access, Virtual Unbundled Local Access and Local Loop Unbundling.

¹⁵ See footnote 4 for more details.

- using BT's wholesale broadband access products sold by BT Wholesale or by LLU operators.
31. The parties overlap at a horizontal level in the supply of retail fixed broadband services, retail fixed bundles (incorporating, for example, fixed broadband and pay-TV) and retail fixed and mobile bundles, and there are vertical links between the parties in that BT provides a number of wholesale fixed services to EE and other MNOs and CPs that are used for the provision of retail fixed services.
 32. We will investigate the extent to which different aspects of retail broadband can be aggregated on the basis of demand-side and/or supply-side substitution. In particular, we may consider:
 - (a) the extent to which broadband and superfast broadband (SFBB) should be considered as separate markets; and
 - (b) the extent to which the retail broadband market has regional differences within the UK (in particular, based on the degree of unbundling of local exchanges).

Assessment of the competitive effects of the merger

Counterfactual

33. We will assess the possible effects of the merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation absent the merger).
34. The counterfactual is an analytical tool used in answering the question of whether the merger gives rise to an SLC. While based on evidence obtained by the CMA in its investigation, it is generally not comparable in detail to its analysis of the competitive effects of the merger.¹⁶
35. We will consider what would have been likely to happen in the foreseeable future if the merger had not taken place. Where there is more than one possible alternative scenario, we will ultimately choose the counterfactual situation that is most likely to have existed absent the merger, based on the facts available to us and the extent of foreseeable future events. We will seek

¹⁶ [Merger Assessment Guidelines](#), which have been adopted by the CMA Board, paragraph 4.3.1.

to avoid importing into our assessment any spurious claims to accurate prediction or foresight.¹⁷

36. In this case, there are three main issues to consider that may lead us to adopt a counterfactual that differs from the prevailing conditions of competition, which are:
- the announced merger of H3G and O2;
 - BT's current and future presence in retail mobile services; and
 - other factors and trends.

Impact of H3G/O2 merger

37. The H3G/O2 merger would bring together two of the four current MNOs in the UK. It falls within the jurisdiction of the EU merger control regime (and not the UK regime) and is conditional on merger control clearance by the Commission. The Commission will be assessing whether the H3G/O2 merger results in a significant impediment to effective competition (SIEC) in all relevant markets. It is not being reviewed by any other competition authority (although it is possible that it could be referred to another national competition authority such as the CMA following a request under Article 9 of the EU Merger Regulation).
38. For our purposes, there are three possible outcomes for the H3G/O2 merger:
- The transaction proceeds as currently proposed, with the Commission's investigation not resulting in any competition remedies.
 - The transaction proceeds subject to such remedies (with a wide range of possible remedies).
 - The transaction does not proceed, due to prohibition by the Commission or for any other reason.
39. It is not possible at this stage to predict the outcome of the Commission's investigation into this parallel transaction or the precise impact that this outcome will have on competition in markets relevant to BT/EE in the UK. We will need to take developments in the H3G/O2 merger into account as we would any other market developments. The prevailing level of competition might exist in the counterfactual not only as a result of the H3G/O2 merger not proceeding, but also as a result of any SIEC being fully remedied by the

¹⁷ [Merger Assessment Guidelines](#), paragraph 4.3.6

Commission, although any differences between those two scenarios may need to be considered in our competitive assessment.

40. We recognise that particular issues may arise if any of our theories of harm would not give rise to an SLC finding if the H3G/O2 merger does not proceed, but would give rise to an SLC finding if it does proceed, especially if it relates to an aspect that would not be considered and/or remedied by the Commission's investigation (for example because it occurs in a market that is not an affected market for the purposes of the Commission's investigation).

BT presence in retail mobile services

41. BT has been present as an MVNO in the business segment since 2001. It launched a new consumer offering in March 2015 and BT submits that absent the merger it would continue with its organic growth plans in retail mobile services using femtocell technology and the spectrum it purchased in Ofcom's 800MHz/2.6GHz auction in 2013.
42. The counterfactual will reflect the fact that BT has entered the consumer segment of the retail mobile market. The details of BT's future competitive strength in retail mobile services will be considered as part of the competitive assessment.

Other factors and trends

43. Third parties have suggested other factors and trends that we should consider when determining the appropriate counterfactual. These include (but are not limited to):
- future entry by industry players into new markets;
 - future capacity constraints;
 - future consolidation in the industry;
 - fixed-mobile convergence; and
 - future changes in Ofcom regulation.
44. We will take the above issues into account, where relevant, as part of our competitive assessment rather than as part of the counterfactual.¹⁸

¹⁸ See [Merger Assessment Guidelines](#), paragraph 4.3.2.

Theories of harm

45. Theories of harm describe the possible ways in which an SLC could arise as a result of the merger and provide the framework for our analysis of the competitive effects of the merger. We have set out below the theories of harm that we intend to investigate. However, we may revise our theories of harm as our inquiry progresses. Also, the identification of a theory of harm does not preclude an SLC being identified on another basis following further work by us, or the receipt of additional evidence. We welcome views on all the theories of harm set out below.
46. We have decided that the issues that have been identified to date can be best captured within ten theories of harm – four raising horizontal unilateral effects, four raising vertical effects, one raising co-ordinated effects, and one raising conglomerate effects.¹⁹
47. The concern under a horizontal unilateral effects theory of harm is that the removal of one party as a competitor could allow the merging parties to increase prices, lower quality, reduce the range of their services and/or reduce innovation, all relative to the counterfactual. After the merger, it is less costly for the merging company to raise prices (or lower quality) because it will recoup the profit on recaptured sales from those customers who would have switched to the offer of the other merging company.
48. The concern under a vertical theory of harm is that bringing together the merging parties creates or exacerbates the incentive or ability of the merged firm to harm competition at one level of the supply chain through its behaviour at another level of the supply chain.²⁰
49. In addition to considering each theory of harm separately, we will also consider how the theories interact, and consider the effect of the merger in the round.

Theory of harm 1: Retail mobile – unilateral effects arising from loss of potential competition

50. EE is currently a large provider of retail mobile services, and BT is a smaller provider with plans to grow. The merger would remove the constraint on mobile operators, including EE, that BT would have exercised in the counterfactual. This could allow the merging parties to degrade their service, for example by raising prices or reducing quality or innovation relative to the

¹⁹ Theories of Harm 1, 2, 7 and 8 raise horizontal effects and 3, 4, 5 and 6 raise vertical effects.

²⁰ See [Merger Assessment Guidelines](#), section 5.6.

counterfactual, because the merger could reduce the number of customers that would be lost as a result.

51. In assessing these concerns, we will consider, as compared to the counterfactual:
- the extent to which BT would have exercised a significant constraint on EE; and
 - the remaining constraint exerted by other MNOs and MVNOs together, and whether this would be sufficient to prevent the merged entity from degrading its service relative to the counterfactual.
52. Issues we are likely to investigate include:
- (a) the current degree of competition between MNOs and MVNOs;
 - (b) the likely constraint from BT, without the merger. This will include:
 - (i) the impact of BT on the retail mobile market; and
 - (ii) BT's strengths (including options not open to other MVNOs) due, for example, to BT's strong position in fixed voice, broadband and/or TV, or to BT's spectrum and other assets;
 - (c) trends, including the demand for data and fixed-mobile bundles;
 - (d) capacity constraints and their impact on competition; and
 - (e) the impact of future spectrum releases

Theory of harm 2: Retail mobile – dynamic loss of competition

53. The second potential source of harm to competition is that the merger will (in the medium to long term) weaken competitors to EE and BT such that they will impose less competitive constraint than they would have done in the counterfactual (this is distinct from Theory of Harm 1, under which our concern is about the constraint imposed by BT).
54. Some third parties have argued that the merger will result in EE having greater capabilities post-merger that it will not be possible for competing mobile operators to match. They argued that this may subsequently lead to other operators being less able to compete (than in the counterfactual), that competition in the longer term would be harmed, and that the merged entity may be able to set higher prices or lower quality in the longer term. On the basis of the evidence currently available to us, potential advantages of the

merged entity over EE absent the merger include: (a) the amount or type of spectrum held, (b) access to BT's Wi-Fi hotspots and/or other network sites; (c) access to backhaul on improved terms; and (d) increased opportunities for cross selling and bundling.

55. The argument against this theory of harm is that any improvements in EE's offer might be viewed as efficiencies and of potential benefit to consumers. In principle, our concern is to protect competition and not competitors who fail to invest and innovate. In order to have a concern, we would have to believe that improvements in EE's offer due to the merger would permanently weaken competitors to an extent that the merged entity could exploit consumers. We invite comments as to whether, and how, this is likely.

Theory of harm 3: Wholesale mobile input foreclosure/loss of competition

56. The concern under this theory of harm is that, as a result of the merger, the merged entity would have both the ability and incentive to refuse to supply, or offer worse terms for, wholesale mobile services to those MVNOs, with which it competes in relation to the supply of fixed/mobile bundles. This would lead to reduced choice of wholesale mobile supplier for affected MVNOs, and potentially worse terms, which could in turn affect retail competition.
57. In particular, the merged entity may be able to:
- (a) degrade, within the existing contract, the quality of the wholesale mobile services that EE currently provides to Virgin Media; and/or
 - (b) in future, restrict or degrade the supply of wholesale mobile to other suppliers of fixed/mobile bundles services (by not bidding for or bidding less competitively for contracts to supply them), such that those suppliers face higher prices or lower quality because of a lack of sufficient alternative providers of wholesale mobile services competing to supply them.
58. We will investigate:
- (a) the ability of the merged entity to foreclose, by assessing for example the extent to which EE refusing to supply would place MVNOs offering fixed/mobile bundles in a significantly worse bargaining position and affect their position at the retail level;
 - (b) the incentive of the merged entity to foreclose, which would arise from the combination of EE, an MNO, with BT, the largest provider of fixed communication services (including in particular broadband and pay-TV). This would depend upon the degree to which the foreclosed MVNO's

retail customers might be expected to switch to products sold by the merged entity, and the relative profitability of wholesale and retail services; and

- (c) the effect on customers, by assessing for example the extent of any possible resulting price rise or degradation in quality by MVNOs that provide fixed/mobile bundles, and its effect on consumers. This will depend on the extent to which these MVNOs face competition from other providers of fixed/mobile bundles and/or suppliers offering unbundled services.

Theory of harm 4: Mobile backhaul input foreclosure

- 59. The concern under this theory of harm is that, as a result of the merger, the merged entity would have both the ability and incentive to engage in partial input foreclosure in the supply of its mobile backhaul products. This could be effected by, for example:
 - (a) increasing the prices of products supplied to competing MNOs;
 - (b) lowering the quality of products supplied to competing MNOs; and/or
 - (c) frustrating innovations in these products that could benefit competing MNOs.
- 60. Our initial view is that this theory of harm is more likely to arise in relation to the supply by BT Wholesale of managed mobile backhaul services and in particular, the supply of MEAS²¹ and, to a lesser extent, the supply by Openreach of unmanaged mobile backhaul services. We may consider the extent to which these, and other services, are substitutes, and whether harm could arise from degrading one service but not the other.
- 61. We will investigate:
 - (a) the ability of the merged entity to partially foreclose competing MNOs, by for example assessing any restrictions imposed on it by regulation and existing contracts, and its ability to vary prices and quality;
 - (b) the incentive that the merged entity would have to partially foreclose competing MNOs, by for example assessing the likely gains at the retail level and lost income or higher costs at the wholesale level; and

²¹ Managed Ethernet Access Service.

(c) the effect that the partial foreclosure would have on competition at the retail level, for example the impact an increase in price or degradation in quality would have on affected MNOs and how this would translate into a change in their retail offering; and affected MNOs' ability to switch to competing inputs.

62. We are also likely to consider the extent to which:

(a) MNOs depend on Openreach (or BT Wholesale) for innovation in backhaul and how this may change if MNOs have access to dark fibre; and

(b) there are identifiable technical innovations which may be more favourable to rival MNOs than EE (now or in the future).

Theory of harm 5: Mobile backhaul customer foreclosure

63. The concern under this theory of harm is that, as a result of the merger, the merged entity would have both the ability and incentive to engage in customer foreclosure of other suppliers of communications infrastructure that competes or may compete with BT's offering. In particular, we have identified a concern around mobile backhaul products.

64. MNOs currently source mobile backhaul from BT Wholesale as well as other suppliers. In the case of EE, choice of supplier is made by MBNL, EE's joint venture with H3G. As a result of the merger, the merged entity may have an incentive to self-supply (ie source all of its mobile backhaul requirement from BT). This could have the effect of foreclosing other actual or potential suppliers, which may in turn impede the rollout of fibre networks which can compete with BT not only for mobile backhaul but also more widely in the supply of wholesale local access (for example in the supply of FTTC²² and FTTH).²³

65. We will investigate the extent to which the merged entity has the ability and incentive to foreclose other suppliers, and the effect of this foreclosure strategy on other actual and potential customers of those suppliers.

²² Fibre to the Cabinet. Access network consisting of optical fibre extending from the access node to the street cabinet.

²³ Fibre to the Home. A form of fibre optic communication delivery in which the optical signal reaches the end user's home.

66. Issues that we are likely to consider include:
- (a) the extent of EE's influence over MBNL's decisions, and the way in which commercial decisions are taken by MBNL;
 - (b) the merged entity's incentives to switch from other (current or putative) suppliers to BT;
 - (c) the extent of suppliers' operations in the UK and how these would be affected by the loss or reduction in scope of custom from MBNL; and
 - (d) the impact of other suppliers' operations rollout network on competition to provide wholesale local access to communication providers and backhaul more generally.

Theory of harm 6: Wholesale broadband – input foreclosure

67. The concern under this theory of harm is that, as a result of the merger, the merged entity would have both the ability and incentive to increase the price or degrade the quality of the wholesale inputs that rival communication providers need to provide retail broadband services, in particular LLU products and, for SFBB, VULA.
68. In order to provide fixed broadband services to a customer, retail operators must connect their core network with the customer's premises. They can do this by:
- using the provider's own access network;
 - unbundling BT's local exchanges and using Openreach's inputs (LLU or VULA) for the connection between the local exchanges and the customers' premises; or
 - Using Wholesale Broadband Access (WBA) products sold by BT Wholesale or by LLU operators.
69. We will investigate whether the merger increases BT's ability and/or incentive to partially foreclose competing communications providers, and the effect any partial foreclosure might have on customers.
70. To determine the effect of the merger on BT's ability to foreclose, we are likely to investigate:
- BT's current and post-merger ability to degrade service, given the current regulation in place – including whether the merger will increase complexity in such a way as to make the VULA margin squeeze regulation

ineffective, and whether the merger will increase BT's flexibility to allocate fixed and common costs in such a way to permit an increase in the prices of regulated services (such as LLU); and

- the relevance of potential Ofcom intervention, including the next planned review of Ofcom regulation, possible remedies available to Ofcom, and their impact on BT's ability to foreclose.

71. To assess the change to BT's incentives resulting from the merger, we are likely to investigate:

- (a) whether the merged entity will be a closer downstream competitor to operators offering multi-play packages including mobile, so will have increased incentive to degrade service to those operators (including the likely importance of multi-play packages to competition);
- (b) whether there will be more investment projects that are beneficial to BT/EE that will compete for resources with those that could benefit rivals; and
- (c) how BT prioritises its investments in its networks, and how its decisions may be influenced by the merger.

72. Finally, we will consider the effect that any foreclosure would have on customers, by for example assessing the extent of any possible price rise or degradation in quality at the retail level.

Theory of harm 7: Retail broadband – unilateral effects arising from loss of competition in rural areas

73. The concern under this horizontal theory of harm is that the merged entity may have an incentive to raise retail prices or reduce quality of broadband provided in some areas (ie those where little LLU has taken place at local exchanges).

74. In rural areas, it is not always profitable to unbundle local exchanges, so retailers rely on BT Wholesale to provide broadband services. Ofcom has divided local exchanges into two types according to whether they have been unbundled and to what extent. It has previously classified BT, Sky, TalkTalk, Vodafone and Virgin Media as 'principal operators' (POs), and distinguished between exchanges in 'Area A' where there were no more than two POs present or forecast to be present through their own network or LLU, and exchanges in 'Area B' where there are three or more present. Ofcom imposed a price control and other remedies on BT's WBA product in Area A.

75. Within Area A, BT has a high retail market share. Although EE has a small share overall, EE is present at the retail level in some areas where only one principal operator (BT) is present with its own network and there is only a small number of operators reselling BT's product.
76. To investigate this theory of harm we may:
- (a) clarify market shares across different exchange types, the number of exchanges where BT and EE are present with only limited other competition present, and the variation in prices;
 - (b) assess how competition and pricing works at these exchanges (and differs from other exchanges), including, for example: how BT, EE and other operators set their retail prices; how products are differentiated; and how products provided through WBA differ from those offered through LLU; and
 - (c) investigate the ability and plans of other operators to provide a retail offer at the exchanges in question.

Theory of harm 8: Retail broadband – unilateral effects arising from potential loss of competition in superfast broadband

77. BT and EE both provide SFBB. BT and Virgin Media (VM) both have substantial shares of supply in the UK, but VM offers this only within its network area. EE currently has a small share of SFBB customers. However, two third parties have raised concerns that, particularly outside VM's network area, BT currently has a strong position in SFBB and there are relatively few competitors that could constrain it. They argue that SFBB customers have generally upgraded from regular broadband, and that EE's existing broadband customer base makes it one of the few plausible competitors in SFBB. The merger would remove this competitive constraint, which could lead to higher prices or lower quality.
78. To investigate this theory of harm we are likely to investigate:
- (a) whether SFBB is and will continue to be constrained by broadband, or whether it should be considered a separate market;
 - (b) the level of market shares in broadband and SFBB to assess whether BT's share could in theory be significantly increased due to the merger;
 - (c) the extent to which SFBB customers are acquired through upgrade rather than switching between alternative providers; and

- (d) the extent of competitive constraints in SFBB absent the merger, including EE's plans.

Theory of harm 9: coordinated effects

79. In principle, concerns may arise in relation to coordinated effects where we think that three conditions are met:
- (a) Firms can reach and monitor the terms of coordination (eg by setting prices or sharing customers).
 - (b) Coordination is internally sustainable among the coordinating group – ie firms find it in their individual interests to coordinate.
 - (c) Coordination is externally sustainable, ie competition from outside the coordinating group is unlikely to undermine it.²⁴
80. We generally have more concerns about coordinated effects where a merger increases symmetry in an affected market, which in turn may align the interests of competitors to coordinate rather than compete; this makes coordination more internally sustainable.
81. In this case, the merger brings about relatively small changes to market shares in most affected markets and generally makes the share of the market leader larger (ie makes it less similar to its competitors). Therefore it is unlikely to create a greater risk of coordinated effects. The merger does increase multimarket contact (eg between fixed and mobile products), but again does not lead to a situation where firms are likely to have similar incentives.
82. Therefore, it appears unlikely to us at this stage that the merger would increase the likelihood of coordinated effects. However, should any party have reason for believing that we should further investigate this possible harm separately, it should tell us and provide a reasoned submission.

Theory of harm 10: conglomerate effects

83. In principle, concerns may arise about conglomerate effects where we think that the merged firm might increase the selling price of one of its products when sold on a stand-alone basis, but might not do so if customers buy both the merged firms' products; this would give customers an incentive to buy the

²⁴ See [Merger Assessment Guidelines](#), section 5.5.

second product from the merged firm as well, putting rivals in the second product market at a disadvantage.²⁵

84. It has been suggested by third parties that we may wish to consider whether any conglomerate effects arise as a result of the transaction.
85. It appears unlikely to us at this stage that the merger would result in any conglomerate effects in addition to effects already considered in the competitive assessment of the identified theories of harm. However, should any party have reason for believing that we should further investigate this possible harm separately, it should tell us and provide a reasoned submission.

Countervailing factors

86. We will consider whether there are countervailing factors which are likely to prevent or mitigate any SLC that we may find. In particular, we intend to consider entry and expansion, buyer power and efficiencies.
87. We are not currently aware of any other countervailing factors.

Entry and expansion

88. We will consider how easy it is to enter and expand supply of retail mobile, wholesale mobile, mobile backhaul, wholesale broadband and retail broadband services, and whether entry and/or expansion could be expected to be timely, likely and sufficient to prevent any SLC. To do this we will:
 - (a) look at the history of actual entry, expansion and exit by the parties and by their competitors, and review any existing plans for entry or expansion;
 - (b) examine the factors which might inhibit entry or the expansion of existing competitors; and
 - (c) consider the cost of expanding or developing new infrastructure and services, and the importance of scale, reputation, brands and other incumbency advantages.

Buyer power

89. We will assess whether any customers of BT and EE have countervailing buyer power, and whether the buyer power of these customers would be

²⁵ See [Merger Assessment Guidelines](#), paragraph 5.6.13.

sufficient to protect customers from any effects of an SLC. We would also consider the likely impact of the merger on any pre-existing countervailing buyer power.

Efficiencies

90. We will examine any arguments made in relation to efficiencies arising from the merger. In particular, we will examine whether any potential efficiencies are rivalry-enhancing and could be expected to offset any loss of competition.²⁶

Possible remedies and relevant customer benefits

91. Should we conclude that the merger may be expected to result in an SLC in any market(s), we will consider whether, and if so what, remedies might be appropriate, and will issue a further statement.
92. In any consideration of possible remedies, we may have regard to their effect on any relevant customer benefits in relation to the merger and, if so, what these benefits are likely to be and which customers would benefit.

Responses to the issues statement

93. Any party wishing to respond to this issues statement should do so in writing, by no later than **5pm on 31 July 2015**. Please email BT.EE@cma.gsi.gov.uk or write to:

Project Manager
BT/EE merger inquiry
Competition and Markets Authority
Victoria House
Southampton Row
LONDON
WC1B 4AD

²⁶ Note that some efficiencies will be investigated in the assessment of Theory of Harm 2.