



**Response to the CMA's Invitation to Comment on proposed
BT/EE merger**

TalkTalk submission

Redacted version

May 2015

1 Summary

- 1.1 This submission responds to the CMA's Invitation to Comment, issued 18 May 2015, on the proposed merger between BT and EE.
- 1.2 This document sets out TalkTalk's views in two primary areas:
 - the merging parties' request for a 'fast track' reference to a phase 2 merger inquiry; and,
 - the various substantive issues (in the form of 'theories of harm') raised by the proposed merger.
- 1.3 TalkTalk considers that this merger should not be referred to phase 2 on a fast track basis, as the relevant conditions for fast-track referral, as set out in the CMA's guidance, have not been fulfilled. Rather, the CMA should use the information-gathering powers which it has recently acquired in phase 1 cases to undertake a fuller investigation over the statutory 40 working days permitted at phase 1, ensuring that any reference to phase 2 is undertaken after suitable review and on the basis of appropriately detailed theories of harm, rather than solely one or more theories of harm which the merging parties accept meet the test for reference.
- 1.4 Regarding the substantive issues raised by the merger:
 - TalkTalk considers that there will be a significant lessening of competition in the market for the provision of wholesale MVNO agreements caused by the vertical merger of EE's mobile network with BT's consumer broadband business. BT is a generally unwilling wholesaler across all of its products, and in particular is very unlikely to be willing to offer wholesale MVNO deals to providers planning to offer bundled products which would compete with its own integrated products.
 - TalkTalk considers that there will be a significant lessening of competition in the market for consumer mobile telephony. EE is by some distance the largest retail mobile network in the UK, while BT had just begun the process of entering the consumer mobile market prior to bidding for EE. BT would have had a different business model from the existing MNOs, and would have been highly motivated to win market share and disrupt the market. The loss of such an aggressive competitor is liable to harm consumers.
 - TalkTalk considers that there may be a significant lessening of competition in the market for supplying mobile voice and data products to SMEs, due to the substantial role of the merging parties in this market.
 - TalkTalk considers that there will be a significant lessening of competition in the UK market for superfast broadband (SFBB), particularly in areas where Virgin Media is not present. BT's market share in SFBB outside Virgin areas is in excess of 70%, and it continues to win the majority of new connections. By purchasing EE's SFBB base BT will eliminate a significant competitor which has been growing rapidly in recent months, and which has a distinctive brand built around speed of internet access.

- TalkTalk considers that there will be a significant lessening of competition for broadband customers in areas where Virgin is not present and where the local exchange has not been unbundled. In such areas, the only two meaningful competitors to BT are EE and Sky, and even Sky does not actively promote sales in such areas. The merger is therefore a 3-to-2 merger in a market where there has been no recent scale entry (and a number of withdrawals). BT already price discriminates against customers in such areas.

- 1.5 The most serious of these concerns is what effectively amounts to a 2-to-1 merger in the market for the supply of wholesale MVNO terms. This merger therefore has the scope to eliminate the competitive fringe of MVNO players, concentrating the market down to just the three MNO operators.
- 1.6 TalkTalk also considers that there are no merger-specific efficiencies which would be passed on to consumers and offset the various SLCs outlined above. We set out a number of the efficiencies that BT has publicly argued will exist, and find that all of them can either be achieved in the absence of the merger, or are not an increase in economic efficiency in any case.
- 1.7 As such, on the substantive issues, TalkTalk considers that the merger should be prohibited unless undertakings are agreed suitable to address all of the SLCs outlined above.

2 The request for a fast track reference to phase 2

- 2.1 TalkTalk notes from the CMA's press release regarding its commencement of consideration of the merger that the merging parties have requested that the merger is referred to phase 2 on a 'fast track' basis, and that the CMA is considering that request.
- 2.2 In TalkTalk's view, the hurdle for 'fast track' reference to phase 2 should be high. There are a number of disadvantages to a phase 2 reference:
- the CMA has less time, overall, to consider the impact of the merger, potentially leading to less considered decisions, particularly in complex cases;
 - in particular, the CMA will be constrained considerably in the time that it has to draft a referral document to phase 2, potentially restricting the scope of the statement of issues published by the CMA panel;
 - there is less time for third parties to comment on the merger at an early stage of proceedings, and in particular less scope to influence the statement of issues;
 - if any third parties should wish to commission expert economic or legal evidence or reports, then there is little time to do so at phase 1, and even the time to influence phase 2 is likely to be compressed.
- 2.3 All of these problems occur in the current instance. In particular, TalkTalk considers that a fast track reference will reduce the CMA's scope to consult interested

competitors and customers in detail before the CMA comes to draft its issues statement. As that statement tends to frame the remainder of the investigation, this could significantly prejudice the outcome of the CMA's review of the case.

- 2.4 Moreover, TalkTalk does not consider that it is likely that the test in §6.63 of the CMA's merger assessment guidelines is met. That paragraph states that:

*Merger parties are generally incentivised to seek to remedy competition concerns by means of UILs where this is feasible. Candidate cases for fast track reference for a Phase 2 investigation are therefore likely to be cases where, **to the extent that the CMA does find a concern with the merger, that concern would impact on the whole or substantially all of the transaction, and not just one part (that could be resolved through structural UILs – see chapter 8)**. [emphasis added]*

- 2.5 This implies that a fast track reference is only appropriate where undertakings in lieu are not feasible. Therefore, TalkTalk considers that, in light of this paragraph, it is incumbent upon the merging parties to demonstrate that there are no structural undertakings in lieu of reference (such as divestments of customers and/ or spectrum) which would be able to remedy the SLCs created by the proposed merger. TalkTalk does not consider that BT and EE would be able to do so; given the structure of the markets affected by the merger, it should be possible to create structural undertakings (albeit substantial ones) which would remedy the harms to competition caused by the prospective merger. Such structural remedies would depend upon the specific SLCs that the CMA found, but could include such remedies as divestment of parts of the BT and/ or EE customer base, and/or divestments of spectrum to new entrants. Given the scale of the transaction (EE, the smaller of the two parties, is being acquired for £12.5 billion) then structural remedies comprising the divestment of assets worth even several billion pounds would not plausibly appear to meet the condition of affecting 'the whole or substantially all of the transaction'.
- 2.6 Overall, therefore, TalkTalk considers that the CMA should decline the parties' request for a fast track reference to phase 2. In a case of this magnitude and complexity, it is important that the CMA takes all the time required in order to make appropriate decisions and to allow third parties fully to comment on competition aspects of the proposed merger.

3 Substantive issues raised by the merger

- 3.1 TalkTalk has previously set out its views on the substantive issues raised by the proposed merger in its March 2015 submission to the CMA in response to the CMA's preliminary invitation to comment. Where these views have changed in the intervening period, we note this below; where we do not comment on an issue in this document, but did so in our earlier submission, that earlier submission should be assumed to continue to represent TalkTalk's views.
- 3.2 Also as previously outlined at section 2 of our March submission, TalkTalk considers that the appropriate counterfactual to the proposed merger is that:

- BT and EE would remain separate competitors;
- both BT and EE are active in the markets that they are currently present in (or have committed to enter i.e. mobile in case of BT); and,
- the merger of O2 and Three is completed without remedies

3.3 Adopting any other counterfactual would be inappropriate, as for instance it would involve pre-judging the outcome of the European Commission's consideration of the Three/O2 merger, which is outside the CMA's control.

3.4 TalkTalk considers that the merger will or may cause SLCs across a wide range of markets, particularly:

- there will be an SLC in the market for wholesale MVNO agreements, caused both by the merged firm's increased share of spectrum, and the increased incentive to refuse MVNO agreements to firms which might use them to supply communications bundles including both fixed line and mobile elements;
- there will be an SLC in the consumer mobile retail market, due to the elimination of BT as an entrant to the market, and the impact of the merged firm increasing MVNOs' costs and so weakening overall competition in the market;
- there may be an SLC in the SME mobile retail market, due to the merger of two of the largest players in that market, and the high prevailing barriers to entry based around customers' brand preferences;
- there will be an SLC in the SFBB market, due to the combination of two of the five members of the relevant competitor set in a market characterised by high barriers to entry;
- there will be an SLC in the standard broadband (“SBB”) market in areas where exchanges have not been unbundled, due to the merger reducing the number of active competitors from 3 to 2, reinforcing BT's existing price discrimination against customers in these areas.

3.5 This is a significant list of anticompetitive effects of the merger, which the CMA should seek carefully to investigate.

3.1 **There will be an SLC in the market for wholesale MVNO agreements**

3.6 In line with our previous submission, TalkTalk considers that the proposed merger of BT and EE will significantly lessen competition in the market for wholesale MVNO agreements. The merger will reduce the number of active MVNO wholesalers from two to one, and would thereby make it difficult, or in some cases potentially impossible, for firms wishing to enter into an MVNO agreement in order to provide bundled products including both fixed-line and mobile access.

3.7 [Redacted]

- [Redacted]¹ [Redacted]
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3.8 We now understand that Vodafone is in the process of withdrawing entirely from the MVNO market. TalkTalk understands that Vodafone has served notice to terminate the MVNO agreement that it has in place with Sainsbury's, and the agreement it had with Carphone Warehouse is also ending. As pointed out above, Vodafone also chose to terminate TalkTalk's MVNO agreement without warning. A firm with no active MVNO agreements in place (that are not in their notice periods) and which is [redacted], cannot be considered to be a competitor in the wholesale MVNO market.

3.9 In the appropriate counterfactual to the proposed BT/EE merger, O2 will have been acquired by Three. Prior to the BT/ EE merger there will therefore already be only two potential MNO suppliers to a firm wishing to enter into a new or extended MVNO agreement (EE and the merged Three/ O2).

3.10 TalkTalk considers that the merger of BT and EE would further contract the number of potential suppliers of MVNO agreements from two to one:

- BT would have the ability to refuse to supply wholesale MVNO agreements on commercial terms, as it would be under no regulatory obligation to supply and would have full control over EE.
- BT would have the incentive to refuse to supply wholesale MVNO agreements on competitive terms because by doing so it could restrict competition from Sky, TalkTalk and Virgin Media in the rapidly-growing market for consumer bundles including both fixed line and mobile access. It would not fear the reaction of other providers (particularly in the medium term) due to the high concentration in the MNO market and the high barriers to entry to that market (see below).
- BT's history shows that it is unwilling to supply downstream competitors to BT Retail unless compelled to do so by regulation. A recent example is provided by the continual demands for dark fibre access by almost all downstream competitors (including TalkTalk, Sky, EE, Vodafone and Three) which have been continually rebuffed by BT Openreach. Due to BT's refusal to negotiate commercially, Ofcom has recently proposed to mandate regulated access to dark fibre products— a decision which has been criticised by BT. Similarly, [Redacted] TalkTalk considers that BT's general approach is to refuse to supply wholesale products where they would compete with its own downstream businesses unless compelled to do so, and that it would adopt such a strategy in the MVNO market.

¹ [Redacted]

3.1.1 The supply of wholesale mobile capacity is highly concentrated

- 3.11 In order to supply MVNOs with capacity, MNOs themselves need sufficient capacity, generally in the form of spectrum.² Following the proposed merger, the merged BT/EE will hold a large proportion of the total UK spectrum that has been released for use for mobile voice and data. Given other features of the market, this quantity of spectrum is consistent with the merged firm holding strong market power in the upstream market for supply of wholesale mobile capacity (whether via self-supply, or to third parties via an MVNO agreement).
- 3.12 The relative shares of different categories of spectrum, both before and after the proposed merger of BT and EE, is presented in Table 3.1, below.

Table 3.1: Spectrum holdings pre-merger

	800 MHz	900 MHz	1800 MHz	2100 MHz	2600 MHz FDD	2600 MHz TDD	Total	Share
Vodafone	10	12.6	5.75	15	20	25	151.7	27%
Three/O2	15	12.2	20.75	25	0	0	145.9	26%
EE	5	0	45	20	35	0	210	38%
BT	0	0	0	0	15	20	50	9%
<i>Total</i>	<i>30</i>	<i>24.8</i>	<i>71.5</i>	<i>60</i>	<i>70</i>	<i>45</i>	<i>557.6</i>	

Note: In line with Ofcom's approach in its recent spectrum auction consultations, in the 'total' column all paired blocks of spectrum (all blocks other than 2600 MHz TDD) have their total spectrum doubled, to reflect pairing.

- 3.13 As can be seen, even pre-merger EE has by far the largest quantity of spectrum, including the vast majority of the premium 1800 MHz spectrum, which is widely supported on handsets and offers the optimal balance of range of coverage and bandwidth capacity. Table 3.2 demonstrates the position post-merger.

Table 3.2: Spectrum holdings post-merger

	800 MHz	900 MHz	1800 MHz	2100 MHz	2600 MHz FDD	2600 MHz TDD	Total	Share
Vodafone	10	12.6	5.75	15	20	25	151.7	27%
Three/O2	15	12.2	20.75	25	0	0	145.9	26%
BT/EE	5	0	45	20	50	20	260	47%
<i>Total</i>	<i>30</i>	<i>24.8</i>	<i>71.5</i>	<i>60</i>	<i>70</i>	<i>45</i>	<i>557.6</i>	

- 3.14 Post-merger, BT/EE will hold approximately half of the spectrum available for mobile voice and data in the UK. This is a level of capacity which can be consistent with a dominant position where there are capacity constraints and high barriers to entry and expansion in a market.

² Spectrum and capacity in mobile markets are close to synonymous. All mobile communications need sufficient spectrum to enable them to occur; the greater the spectrum an operator has, *ceteris paribus*, the greater the capacity to serve calls and data. Mobile operators can also increase capacity by increasing the number of base stations, but this can be restricted by both the economic costs of building and maintaining more sites, and through planning restrictions.

3.15 Furthermore, in order to make use of spectrum to provide downstream customers with MVNO agreements, a mobile operator will require access to a national network of masts. At present there are only two such scale national networks– Cornerstone, which is a joint venture between Vodafone and O2 and MBNL, which is a joint venture between EE and Three. There are at present no other mast networks which would offer national coverage sufficient to be able to offer a viable MVNO deal to third parties.³

3.1.2 There are high barriers to entry and expansion in the UK market for mobile capacity to provide MVNOs

3.16 As set out above, in order to offer MVNO agreements, a potential entrant would need access both to a national network of masts located suitably to serve a high proportion of the geographic area of the UK (likely in excess of 90%) and sufficient spectrum both to be able to serve its own retail customers (if any) and to provide a high quality of service to third parties.

3.17 TalkTalk considers that the minimum volume of spectrum required in order to be able to wholesale MVNO agreements would depend upon the business model adopted:

- [Redacted].⁴ Any less than this and it would be insufficient to offer a reasonable level of service to larger MVNOs such as Tesco Mobile or Virgin Media's MVNO.
- [Redacted]

3.18 There is no scope for an entrant to acquire such spectrum in the medium term.⁵ All spectrum in these ranges is currently held by the various incumbent MNOs (including BT) and TalkTalk is not aware of any MNO ever having voluntarily sold spectrum to a new entrant.

3.19 There is a forthcoming auction of spectrum in the 2300 GHz and 3400 GHz ranges. However, such spectrum has serious drawbacks associated with it:

- handset support is currently very limited. For example, there are no smartphones or featurephones currently available in Europe which support the 3400 MHz band, [Redacted]. The 2300 MHz band is supported by the latest iPhones, but is not supported by any Samsung or Windows Phone models available in Europe. This severely limits the scope of an entrant using these bands to offer service.
- [Redacted].

³ MNOs also tend to have a smaller number of masts which sit outside these mast networks and which are owned and used individually. These are also unlikely to be accessible.

⁴ [Redacted]

⁵ TalkTalk considers that 700 MHz spectrum, even when this is eventually auctioned, is unlikely to be appropriate to allow entry without other spectrum, as it is best suited to deep rural deployment where range, rather than capacity, is the core business goal.

- the 2300 MHz and 3400 MHz spectrum is not proposed by Ofcom to be auctioned until the end of this year, and even then only in part. At present, therefore, there can be no certainty that the auction will have been conducted, and spectrum allocated and ready to use, within any specific timeframe. Even after the award of spectrum, there will likely be a considerable interlude before effective products could come to the market, due to the need to construct macrocells or metrocells making use of the new spectrum, or acquire femtocells at the appropriate frequency and distribute them to customers.

3.20 As such, it is implausible that there will be entry using 2300 MHz and 3400 MHz spectrum sufficient to constrain incumbents in the market for wholesale mobile capacity over the next 2-3 years. Even over a much longer timeframe (say, 5 years) it is unlikely that an entrant would be able to build a sufficiently high quality network using this spectrum fully to constrain the three MNO incumbents.

3.21 Moreover, in order credibly to engage in wholesale provision of mobile capacity an entrant will need national coverage based on a macrocell mast network; although femtocells and metrocells can enhance indoor coverage in mostly urban areas, they are not capable of providing widespread outdoor coverage in rural and suburban areas. There will therefore be several barriers to entry resulting from a need for macrocell masts:

- there is no obvious mechanism for accessing the two existing mast networks, Cornerstone and MBNL, in the absence of regulatory intervention. It is unlikely that incumbents would have incentives to wholesale access to these mast networks on competitive terms, given the scope for undermining the profitability of their wholesale and retail operations;
- greenfield construction of a stand-alone mast network would likely be uneconomic for a new entrant; the current structure of the mobile mast sector is that masts (and in the case of MBNL backhaul as well) are shared between incumbents because of the high fixed costs of masts and backhaul;
- other mast providers (such as Arqiva and Airwave) would be unlikely to facilitate national coverage based on 2300 MHz spectrum given the locations and number of their mobile masts.

3.22 There is therefore a second barrier to entry facing potential entrants into the wholesale mobile market due to the likely difficulties in accessing a suitable mast network.

3.23 A third (albeit weaker) barrier to entry created by the current structure of the MVNO market is the need to acquire contracts in light of the switching costs inherent in the MVNO market. The market predominantly works on the basis of a moderate number of major MVNOs (such as TalkTalk, Virgin, Tesco, ASDA, Lebara, etc.) which enter into multi-year deals with providers of wholesale mobile capacity. As a result, contracts come up relatively infrequently, meaning that a new entrant would take time to win market share even if it acquired a high share of all MVNO contracts coming to the market. Furthermore, [redacted].

3.24 For example, [redacted].

3.25 The combination of these barriers to entry means that there is no realistic scope for new entry into the MVNO market which would constrain the incumbent suppliers (BT/EE, Vodafone, and Three/O2) in the absence of regulatory intervention through the merger control process. These barriers to entry– which between them amount to blockaded entry– further enhance the market power of the incumbents beyond the levels which would be expected even given their high market shares in wholesale mobile.

3.1.3 The merger of BT and EE will lead to an SLC in the supply of MVNO agreements

3.26 Overall, therefore, the merger of BT and EE will lead to an SLC in the supply of MVNO agreements due to the concentration of the market for mobile capacity:

- There is currently limited supply in MVNO market as Vodafone has withdrawn and Three appears to be a reticent wholesaler;
- the number of potential wholesalers of mobile capacity to firms wishing to use it to offer MVNOs as part of a bundled package will drop from 2 to the merged O2/Three as a monopoly provider;
- the merged parties will have a share of UK mobile spectrum close to 50%, with a particularly large holding of the most valuable 1800 MHz spectrum; and,
- there are high barriers to entry which are likely to frustrate new entry into the provision of mobile networks in the absence of regulatory intervention.

3.27 TalkTalk expects that the merger of BT and EE will [redacted].

3.2 There will be an SLC in the consumer mobile market

3.28 As has been set out in section 3.1, the impact of the merger will be to further concentrate the already concentrated market for wholesale mobile capacity, reducing competition in the MVNO market, particularly for firms wishing to use an MVNO service to offer bundles of fixed line and mobile services.

3.29 The merger will also create an SLC in the market for consumer mobile voice and data services. This SLC will arise for two reasons:

- the direct result of the merger, eliminating the threat to incumbents including EE of a significant entrant into the market (BT); and,
- the indirect result of the merger, with a reduction in competition in the market for wholesale MVNO contracts raising the costs of MVNOs active in the consumer mobile market, so making them a less effective constraint on the major incumbent MNOs.

3.30 The remainder of this section first sets out the background to the merger in the consumer mobile market, which is one of swiftly decreasing competition, before detailing the two manners in which this SLC will emerge.

3.2.1 Competition in the consumer mobile market has been diminishing

3.31 Even prior to the proposed merger, competition in the consumer mobile market has rapidly been diminishing, primarily due to the decreasing role of MVNO competitors. Both fixed line and mobile communications markets are becoming increasingly data-centric, as voice usage is declining rapidly. However, due to the relatively uncompetitive terms which are generally offered to potential MVNO operators by MNOs, MVNO are not effective competitors in the provision of packages where data allowances and charge rates are central to the offering.

3.32 This can be seen by the declining market share of MVNOs in the provision of mobile data. In 2011 MVNOs were responsible for 14% of data used by consumer mobile customers; however, this has now fallen to only 7%. Effectively, MVNOs do no more than provide a competitive fringe which places little competitive constraint on the MNOs. The number of customers for operators such as Tesco Mobile and Virgin is therefore a misleading indicator of their competitive impact on MNOs. If more appropriate measures of competitive intensity, such as revenues and data usage volumes, are considered, it can be seen that MVNOs do little to disrupt the MNOs' oligopoly.

3.33 Moreover, there appear to be substantial barriers to entry into the MVNO market in the UK. There has been no new MVNO entry in the past five years which has constructed a scale mobile business. TalkTalk- one of the most successful recent entrants- still only has around half a million subscribers, a market share by subscriber of less than 1%.

3.2.2 The merger will directly reduce competition in the consumer mobile market

3.34 This theory of harm will be dealt with briefly, as it has already been considered in detail at section 3.3 of TalkTalk's March submission in response to the CMA's preliminary invitation to comment.

3.35 EE is a long-standing incumbent in the mobile market, having been formed from the merger of T-Mobile and Orange in 2010. On the other hand, BT has not been an active competitor in the consumer mobile sector until recently. However, in 2013 BT acquired spectrum in the 2600 MHz auction, and announced plans to enter the consumer mobile market on its own behalf. TalkTalk understands that BT is likely to have been looking to use the spectrum it acquired, along with its market-leading number of fixed line broadband customers, to offer a mobile service based on a large proportion of its demand being offloaded to femtocells.

- 3.36 Such a business model, from a major vertically integrated operator with significant competitive advantages derived from its large estate of broadband customers, strong brand, and ability to source backhaul at lower incremental cost than any of its rivals, could have potentially had significant effects on the consumer mobile market. BT would have had strong incentives to offload as much demand as possible to femtocells in order to reduce its cost of service, which could have led to lower incremental costs of offering data to customers and created disruptive pricing in the market. It would have been less vulnerable to reducing competition in the wholesale MVNO market than other non-MNO operators, as its extensive femtocell network, combined with its 2600 MHz spectrum, would have substantially insulated it from increased wholesale MVNO prices.
- 3.37 As an entrant, BT would have had strong incentives to price aggressively in the wholesale and retail markets so as to grow its market share. BT's own presentation regarding the launch of its mobile product discusses that BT sees itself as a 'lower cost network' able to offer 'compelling propositions at competitive prices' with 'high capacity' and 'high performance'. However, the merger with EE eliminates any such incentives to aggressive pricing, as the merged firm will be concerned about cannibalisation of its existing revenues and customer base. This will directly lessen competition in the consumer mobile sector, and thereby harm consumers.

3.2.3 The merger will indirectly reduce competition in the consumer mobile market

- 3.38 The second form of harm to consumers in the consumer mobile market derives directly from the reduction in competition in the MVNO market outlined at section 3.1, above. By reducing competition in the MVNO market, BT/EE will be able to increase costs of MVNOs (whether it is the supplier to that MVNO or not). These increased costs will be in the form both of increase incremental costs of service, and a poorer quality of service from suppliers of mobile capacity, including such elements as not permitting femtocell offload within MVNO agreements, or not providing access to 4G service.
- 3.39 By increasing rivals' costs, BT/EE can reduce the extent to which they impose a competitive constraint on the pricing of the merged firm. This will both lead to a higher market share for the merged firm (and for the other incumbent MNOs) and higher pricing (the 'umbrella effect' of the anticompetitive practices).

3.3 There may be an SLC in the SME mobile market

- 3.40 Again, this issue was considered in detail at section 3.3.1 of TalkTalk's March submission; it will be briefly reprised here.
- 3.41 Both BT and EE currently offer mobile services to SMEs; BT is likely to do so predominantly as part of bundles including fixed line voice and internet access; while EE is likely predominantly to do so on a stand-alone basis.

- 3.42 Although market shares in the SME mobile market are unclear, due to a lack of market data, TalkTalk considers that it is likely that BT is the market leader in offering bundles including both fixed line and mobile access to SMEs (as BT's market share in fixed line services to SMEs is about ten times that of its closest rival, TalkTalk) and it is also likely that EE is one of the two largest providers of stand-alone mobile services (in the overall UK mobile sector, EE is by some way the largest provider).
- 3.43 There are significant barriers to entry into markets to provide SMEs with communications services. Businesses tend to be relatively cautious when choosing communications providers, and so brand strength and brand recognition is particularly important in this sector. A new entrant that did not have a strong track record or brand strength in the communications sector would be unlikely to be able to take a meaningful market share in the SME mobile sector. Moreover, such an entrant would face exactly the same difficulties in acquiring spectrum and mast access, or in acquiring a competitive MVNO agreement, as entrants in the consumer mobile sector would (see section 3.2 above). SMEs are also likely to perceive there to be significant costs of switching between suppliers, as there will need to be a SIM swap for staff, and numbers will need to be ported between networks.
- 3.44 As such, TalkTalk considers that there is a significant prospect that the proposed merger may lead to an SLC in the market to supply SMEs with mobile services (whether on a stand-alone basis or as part of bundles). The merger would combine two of the leading market participants in an already concentrated market for mobile services to SMEs, in the context of a market with high barriers to entry. It therefore has a realistic likelihood of leading to increased prices or reduced quality of offering.

3.4 There will be an SLC in the superfast broadband market

- 3.45 This theory of harm was dealt with at section 3.1 of TalkTalk's March 2015 submission to the CMA, and TalkTalk confirms that its position on the SFBB market remains broadly unchanged from that earlier submission. This section summarises.
- 3.46 The merger of BT and EE will combine, respectively, the second largest and fifth largest providers of SFBB. Moreover, the largest provider (Virgin Media) is only available to around 45% of households; outside Virgin areas the merging parties are the largest and fourth largest providers.
- 3.47 Both BT and EE have recently been performing strongly in terms of broadband take up, with BT winning a much higher share of recent new SFBB subscribers than its static broadband market share indicates. EE has also been experiencing rapid growth in its broadband base, after years of decline (it is unclear whether this growth is primarily in SFBB or SBB). As such, there may be greater loss of competitive tension in the SFBB market from merging BT and EE than would be indicated on the basis of their static broadband market shares alone.
- 3.48 [Redacted] the BT/EE merger will therefore be a 5-to-4 transaction in the various broadband markets.

- 3.49 TalkTalk also still considers that there are substantial barriers to entry into the SFBB market; there has been no meaningful new entry for several years into either the SFBB or SBB markets, and the market has gradually concentrated through exit and through smaller players being acquired by larger incumbents (for example, O2's exit through sale of its fixed line base to Sky). The main barrier to entry is the high cost of customer acquisition, along with fixed costs of software platform and product creation. Customer acquisition costs are particularly high given the substantial advertising that is prevalent in the consumer broadband market.
- 3.50 Given BT's substantial existing market share, the trend towards BT increasing its market share over time, the differences in competitive intensity between different geographic areas, the small number of competing firms in the market, and the high barriers to entry into the SFBB market, BT's purchase of EE is likely to lead to detriment to consumers of SFBB, through some combination of loss of choice, price increases, and reductions in quality of service.

3.5 There will be an SLC in the SBB market in areas where exchanges have not been unbundled

- 3.51 This theory of harm was dealt with in detail at section 3.2 of TalkTalk's March submission.
- 3.52 There is a significant portion (around 5% by population) of the UK which is outside the Virgin footprint and where the local exchange has not been unbundled. Neither Virgin Media nor TalkTalk is active in these areas: sales to new customers have been stopped, and both Virgin and TalkTalk have agreed to divest their customer bases in these areas. [Redacted].
- 3.53 As such, customers in these areas only have a choice of three major operators at present: BT, Sky and EE. TalkTalk understands that even of these operators, Sky does not actively market its off-net products. The merger will therefore reduce the number of significant active competitors from three to two in these areas.
- 3.54 As set out at §3.14 of TalkTalk's March submission to the CMA, BT already price discriminates against customers in areas which have not been subject to unbundling, by denying them access to BT Plusnet's standard tariff rates. Such price discrimination is only likely to increase following a merger of BT and EE.

3.6 Vertical linkages between BT and EE may increase BT's incentives to raise rivals' costs

- 3.55 As set out at section 3.5 of our March submission, TalkTalk continues to believe that BT will seek to use vertical integration into EE adversely to affect competition through gaming its regulatory system and thereby raising downstream rivals' costs.
- 3.56 It will also increase BT's incentives for BT to advantage its EE mobile arm through the price structure set for mobile backhaul. Even while continuing to adhere to its EoI

obligations and set the same prices to all mobile operators, the flexibility in BT's regulatory system can be used in order to raise rivals' costs. For example, EE may have a different mix of backhaul circuits from other operators (different average circuit length, different mix of bandwidth, or something else). Within the prevailing basket approach to regulating Openreach's leased line prices, BT has the flexibility to increase the price of some products as long as it compensates by reducing the price of others. TalkTalk is concerned that BT may use this freedom to reduce the average price paid by its own mobile arm (currently EE) and increase the price paid by other mobile operators, to the detriment of competition and consumers. In its recent BCMR consultation Ofcom identified that BT had gamed a price basket for Ethernet circuits in just this way. BT may also undertake product developments in a manner that tends to benefit EE over competing operators.

4 The merger will not give rise to any merger-specific efficiencies

- 4.1 As part of their merger submissions, the merging parties may seek to demonstrate that the combination of BT and EE will lead to merger specific efficiencies, within the sense of section 5.7 of the joint OFT/ CC merger assessment guidelines. This section demonstrates that there are unlikely to be any such efficiencies. It considers a range of arguments that BT has publicly made regarding the positive effects of the merger, and demonstrates that either these positive effects will not arise, will not generate consumer benefits, or will not be specific to the merger.
- 4.2 Clearly, this section cannot cover every possible efficiency that could be claimed by the merging parties. However, it covers a number of the more significant arguments that TalkTalk expects to be made in favour of the merger. TalkTalk will be happy to liaise with the CMA to provide its thinking on any further potential efficiencies which are not considered in this section.
- 4.3 *The merger will reduce innovation.* Pre-merger, EE had strong incentives to innovate in the fixed line market, as it was a relatively small but fast growing operator in this market. This provided incentives for EE to adopt different business practices and launch innovative products, as it would not have to risk cannibalising its existing investments or undermining pricing and margins for its existing products. The same incentives existed to an even greater extent to BT in the consumer mobile sector, as BT had no existing consumer mobile base; and had the potential to adopt a radically different (and potentially cost reducing) network structure based on femtocells. Following a merger with EE, BT will have reduced incentives to undertake such a strategy, as by doing so it will likely strand some of EE's investments in spectrum and masts; and, even if it does undertake this strategy to some extent, it will have no incentive to pass the savings on to customers as by doing so it would undermine pricing for the large proportion of the market which are EE customers, and risk starting a price war. The merger will therefore lead to a reduction in innovation.
- 4.4 *The merger is unlikely to increase investment.* There are three broad reasons why a merger could increase investment by the merging parties: it could alleviate capital

market constraints; it could in some way reduce the cost of capital facing the merging parties; or it could increase the internal rate of return from certain investments. None of these appear likely to apply in this case: both BT and EE are very large companies which face liquid capital markets; the cost of capital of the merged firm depends primarily on the asset beta of the merged firm, which will be the weighted average of the asset betas of the merging parties; and there is no reason why the merger will increase the IRR of investments in a situation where both BT and EE were already able to offer retail bundles (through purchasing wholesale fixed and mobile products) and have also been wholesalers to third parties (so were able to achieve economies of scale in their wholesale operations). In particular, there is no reason why the merger should accelerate investments in either ultrafast fixed line broadband (such as FTTH) or 5G mobile. Rather, the reduction in competition resulting from the merger is likely to lead to a reduction in investment as there is less pressure on the merged firm to undertake costly projects.

- 4.5 *The merger will not increase competition for converged or bundled products.* The reasons behind this are set out in section 3 above. Rather, by reducing the number of actively competing firms in the market, the merger will reduce competition for converged products.
- 4.6 *The merger will not increase take-up of broadband or broadband usage.* Broadband usage is already high in the UK (at 82%) and there are many active sellers of broadband. In particular, EE already sold broadband and has had significant incentives to sell broadband products to any of its customer base who did not already have fixed-line internet access. The merger will in fact likely reduce take-up of broadband, as BT will be more concerned than a stand-alone EE of the potential for cannibalising its own margins if it cuts prices to drive products out to new customers.
- 4.7 *There are no unexhausted economies of scale that the merger will enable BT or EE to achieve—* both BT and EE are scale telecoms operators. BT is the largest fixed line operator in the UK, while EE is the fifth largest fixed line operator in the UK. Both are well above minimum efficient scale ('MES'). Similarly, EE is the largest mobile operator in the UK, well in excess of MES. Although BT was a new entrant into the consumer mobile market (and so definitionally cannot have achieved MES), TalkTalk would expect it to have rapidly achieved MES, particularly given the economies of scope in areas such as customer service between its fixed line and mobile businesses.
- 4.8 *There are no economies of scope that the merger will enable BT or EE to achieve—* EE already operates in the fixed line and mobile markets, and has launched a successful TV product. EE therefore already operates in all of the markets that comprise a quad-play bundle.⁶ Similarly, BT has offered both fixed line and TV products for a considerable time, and was in the process of launching its consumer mobile offer. In the counterfactual where the merger did not proceed, TalkTalk expects that BT

⁶ A quad play bundle consists of fixed line voice, fixed line broadband, TV and mobile.

would have successfully launched its consumer mobile proposition, and been a strong integrated quad-play operator. As such, neither BT nor EE will obtain access to merger specific economies of scope.

- 4.9 Overall, TalkTalk considers that there will be no merger specific efficiencies resulting from the proposed BT/ EE merger.