

Simon Davis  
Project Officer  
Competition and Markets Authority  
Victoria House  
Southampton Row  
London

1 July 2015

**TalkTalk Telecom Group PLC**  
**11 Evesham Street**  
**London**  
**W11 4AR**

**T 020 3417 1000**  
**F 020 3417 1001**  
**W [talktalk.co.uk](http://talktalk.co.uk)**

## **Issues that should be investigated by the CMA during its phase 2 assessment of BT/EE**

Dear Simon

This letter forms TalkTalk's response to your email of Wednesday 10 June, requesting any initial comments from TalkTalk in the context of the CMA's phase 2 review of the proposed acquisition of EE Limited by BT Group plc.

This submission focuses on the theories of harm that TalkTalk considers that the CMA should investigate in the merger, and which should therefore be included in the CMA's Issues Statement. Before doing so, it briefly considers the counterfactual to the merger. It is structured in line with the assessment process as set out in the CMA's Merger Assessment Guidelines.

The CMA should be aware when drawing up its Issues Statement, and later when assessing the merger, that many of the theories of harm below interact to reinforce one another. For example, the increased concentration as set out in the horizontal effects section reinforces BT's ability and incentives to use the vertical impact of the merger to distort competition. Similarly, the importance of the technical links between fixed and mobile networks is reinforced by the demand-side economics of bundling.

### **1. Counterfactual to the merger**

The Issues Statement should either set out the counterfactual market situation that the CMA considers will exist in the absence of the merger, or specify that this is one of the issues that is under investigation by the CMA. In either instance, the CMA should provide updates whenever its view of the counterfactual changes. The counterfactual in this case is particularly difficult to determine, for a range of reasons:

- this merger takes place at the same time as the proposed Three/ O2 merger;
- there is the ongoing prospect of some form of transaction between Vodafone and Liberty Global;

- there have been a number of instances of recent entry into markets (EE into pay TV, BT into mobile, Vodafone into consumer broadband) where it is too early to determine whether this entry will be successful;
- Ofcom is envisaging regulatory remedies in the BCMR, such as dark fibre, which may impact some of the theories of harm; and,
- there is the prospect of the 2.3/ 3.4 GHz spectrum auction occurring before the mergers are concluded, altering spectrum holdings.

For the avoidance of doubt, and as set out in our earlier submission of 19 March to the CMA, TalkTalk continues to consider that the appropriate counterfactual is one in which the O2/ Three merger proceeds without remedies. All of our comments in this document are predicated on this counterfactual. If a different counterfactual is adopted it will not affect the validity of the potential theories of harm outlined in this paper and they should still be included in the Issues Statement. An alternative counterfactual may, of course, affect any subsequent substantive assessment.

## **2. Theories of harm to be investigated**

In TalkTalk's view, there are nine plausible theories of harm that should be investigated by the CMA, which can be grouped into a number of categories.

### **2.(a) Non-horizontal effects**

At a high level, the merger will combine BT Retail, the largest fixed line broadband retailer in the UK; BT Openreach, the largest provider of local access and leased lines; and EE, the largest mobile retailer in the UK, into a single company. There are therefore multiple plausible theories of harm due to the non-horizontal effects of the merger, resulting from BT's increased incentives and ability to (partially or wholly) exclude competitors in fixed and mobile retail markets.

Crucially, the link between mobile and fixed networks is both technical and economic. Fixed networks provide backhaul for mobile, and provide a base for potential role-out of new femtocell mobile technology. In addition, there are demand-side complementarities between mobile and fixed, providing further opportunities and incentives for strategic withdrawal of supply by the merged entity.

#### *Withdrawal from the wholesale MVNO market*

The merger will bring together EE (the largest MNO in the the UK, and a key provider of capacity for MVNO agreements) with BT (the largest fixed line provider in the UK). TalkTalk expects that, due to the importance of bundles including both fixed and mobile, EE's wholesale mobile service offering will be at least partially withdrawn from the market by BT post-merger. The merger will increase the incentive of the combined entity to foreclose, or raise the costs, of rival multi-play offerings. As such, this withdrawal is particularly likely to be targeted at providers wishing to use purchased mobile capacity to offer fixed/ mobile bundles. This will enable BT to obtain an advantage in the market

for quad-play bundles, as the ineffective remaining competition in the wholesale MVNO market will lead to other operators paying higher prices.

#### *Foreclosure in the market for mobile backhaul to MNOs*

At present, BT does not own a macrocell mobile network, and so has no incentive to game its pricing or product offering in mobile backhaul (primarily for macrocells, but potentially also for femtocells) to distort competition between different MNOs. However, following the acquisition of EE, BT (via its Openreach division) will have both the ability and incentive to game the pricing and product characteristics of mobile backhaul products in a way which benefits EE. These incentives will be particularly strong because of the prospect that raising rivals' costs in mobile will also (through bundling) advantage BT in fixed. This will tend to distort competition between MNOs, harming competition and increasing already high barriers to entry. There can be no certainty that any of BT's changed incentives as a result of the merger will be remedied by Ofcom's ongoing business connectivity market review.

[Redacted]

#### 2.(b) Horizontal unilateral effects in mobile

##### *Concentration of spectrum holdings*

The merged BT/EE will have around 47% of spectrum currently available for use by MNOs in the UK. Such a large share of spectrum provides the prospect that the merged firm may be able to grow its market share of consumer and SME mobile in the future towards levels consistent with a dominant position, providing the prospect of unilateral effects. Moreover, it also enhances barriers to entry and expansion, as other operators will be constrained in their growth by a lack of spectrum due to the very high share held by BT/EE. In particular, the merged firm will hold a very high share of the 2600 MHz spectrum which is the most suitable spectrum for operators wishing to offer service using innovative approaches based around metrocells and/ or femtocells.

Moreover, under the rules proposed by Ofcom, the merged firm will be permitted to bid for additional spectrum in the forthcoming 2300/ 3400 MHz auction without the presence of the spectrum holding cap that Ofcom generally applies to such auctions. BT and EE will have the incentive to bid aggressively in that auction to exclude potentially innovative entrants from acquiring spectrum which could be used to disrupt either the unilateral or coordinated market power created in the mobile market by the merger.

##### *Loss of actual competition in the SME mobile market*

There is little data available on the SME mobile market, but TalkTalk understands that both BT and EE are likely to be scale providers in this market. There is a realistic prospect that combining BT and EE could provide unilateral market power to the merged firm in this market, particularly when combined with BT's high market share (c.50%) in the

supply of fixed line services to SMEs. The CMA should investigate this complex and opaque market further.

*Loss of actual competition in the consumer mobile market*

At present, BT is operating in the consumer mobile market through its MVNO agreement with EE. The merger will remove BT as a competitor in this market, and add BT's market share to that of EE, already the market leader. It will also remove a recent entrant which was well placed to grow fast within the market, due to BT's strong brand and substantial financial resources to grow its mobile business. The CMA should investigate whether this will lead to an SLC through enhancing EE's unilateral market power in the consumer mobile market.

2.(c) Horizontal unilateral effects in fixed

*Loss of actual competition the standard broadband in deep rural areas*

Virgin Media no longer sells outside of its footprint (having divested its off-net base to TalkTalk); nor does TalkTalk (having divested its off-net base to Fleur Telecom). As such, in areas which have not been unbundled (around the last 5% of the country) only three of the five major national providers are present (BT, EE and Sky). The merger is therefore a three-to-two merger, with the merged firm as the largest operator.

*Loss of actual competition in superfast broadband (SFBB) outside Virgin Media areas*

The merger will combine the largest provider of SFBB in geographic areas where Virgin Media is not available with the fourth largest provider. In these areas, the merged firm will likely have a market share in excess of 70%. This provides a significant risk that the merger will cause unilateral effects.

2.(d) Coordinated effects

*Coordinated effects caused by the loss of actual potential competition in the consumer mobile market*

The merger will effectively eliminate BT from the mobile market (as its smaller mobile division is subsumed into EE). BT had recently begun its entry into the consumer mobile market, but had not yet had sufficient time to make a significant competitive impact at the time when the merger was announced. It is highly likely that BT would have acted as a maverick in the market. This could have disrupted coordinated effects in a market that is particularly susceptible to coordination, with high levels of concentration, very high barriers to entry, relative ease of monitoring consumers' offers, multi-market contact (including through mast-sharing agreements) and symmetric cost bases. BT would have been a maverick in this market, following roll-out of its femtocells, due to asymmetries between BT and incumbents in the market, particularly in its cost structure. Furthermore, given its scale and brand, BT would have been a highly credible competitor.

## 2.(e) Non-price effects

### *Reductions in innovation*

The merger will have the effect of reducing innovation in both mobile and fixed line markets. Whereas EE previously (with a small consumer base but strong brand and marketing database) had strong incentives to innovate and act as a maverick in the fixed line market, following the merger it will no longer have these incentives. The same applies to BT in the mobile market. As such, the merger is likely to reduce the novelty and range of new products coming to the market.

## 2.(f) Other issues

For completeness, TalkTalk also notes that the merging parties' businesses overlap in some other areas, and in particular in the provision of pay-TV and standard broadband in areas where TalkTalk and/or Virgin are present. The CMA may wish to consider whether there are any unilateral or horizontal effects emerging in these markets which may give rise to a substantial lessening of competition. It may also wish to consider whether any conglomerate effects arise as a result of the transaction.

## **3. Conclusion**

TalkTalk welcomes the opportunity provided by the CMA to provide its thoughts into the proposed merger. We would be happy to provide further detail on any of the theories outlined above if it would be helpful to the CMA's assessment.

TalkTalk also values the opportunity to speak directly with the CMA throughout the merger assessment process. We are profoundly affected by the merger, both as a competitor and, more particularly, as a customer of the merging parties. We will therefore particularly value direct contact with both the CMA case team, and the panel, throughout the process, to ensure that our position is clear and to help the CMA in its assessment of the affected markets.

We look forward to working with the CMA throughout its phase 2 assessment.

Yours sincerely

Simon Pilsbury  
TalkTalk Telecom Group plc