DATED 31 JULY 2015

BT/EE MERGER INQUIRY

RESPONSE TO THE STATEMENT OF ISSUES

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Section A - Introduction

1.1 The CMA published its Phase 2 statement of issues on 17 July 2015 (the ***Issues Statement***) setting out the issues which it is likely to consider in its investigation of BT Group's (***BT***) proposed acquisition of EE Limited (***EE***) (the ***Transaction***).

1.2 Given BT's request for fast-track referral to Phase 2, the CMA did not carry out a full Phase 1 investigation and left various points open in its Phase 1 decision of 9 June 2015 (the ***Decision***). BT accepts that the Issues Statement therefore encompasses a broad range of potential issues that the CMA wishes to consider in detail prior to making its final decision. In relation to most of these issues, BT and EE (together, the ***Parties***) have already submitted significant quantities of information and documents which show that the Transaction will not lead to a significant lessening of competition (***SLC***). Therefore, the Parties do not intend to revisit all of those issues again in detail in this response. Instead, this response engages directly with the Issues Statement, dealing in turn with market definition and each theory of harm.

1.3 The remainder of this response is structured as follows:

(a) Section B responds to theories of harm 1 and 2, relating to **retail mobile**;

(b) Section C responds to theory of harm 3, relating to **wholesale mobile**;

(c) Section D responds to theories of harm 4 and 5, relating to **backhaul**;

(d) Section E responds to theory of harm 6, relating to **wholesale broadband**;

(e) Section F responds to theories of harm 7 and 8, relating to **retail broadband**;

(f) Section G responds to theories of harm 9 and 10, relating to **coordinated effects** and **conglomerate effects**; and

(g) Section H comments on **efficiencies**.

1.4 The Parties consider that the Transaction will not lead to an SLC in relation to any of the theories of harm under consideration in the Issues Statement. On the contrary, the Parties consider that the Transaction will enhance competition for the benefit of customers, both businesses and consumers. Furthermore, even if the theories of harm are considered "in the round",[1] the Transaction will not lead to an SLC: it is not the case that there can be any cumulative effect from the various markets considered by the CMA. The merged entity will not have any advantages in relation to technically or commercially converged services that could not be replicated by other providers or other sales methods.

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[1] Issues Statement, paragraph 49.

Section B - Retail mobile

2. Introduction and summary

2.1 In summary, the Parties consider that neither of the theories of harm relating to the retail mobile market identified outlined in the Issues Statement are borne out by the evidence. As a result, neither could result in an SLC in the retail mobile market:

(a) "Theory of harm 1" relates to the loss of BT as an independent MVNO. In order to find that the Transaction would give rise to an SLC in this respect, the CMA would need to conclude that the loss of BT as an independent MVNO would have a significant adverse effect on rivalry within the UK retail mobile market over time so as to significantly decrease the competitive pressure between providers.[2] Yet, the highly competitive nature of the market that existed prior to BT's recent MVNO initiative means that even after BT's removal as an independent MVNO, sufficient competitive constraints will remain post-Transaction to ensure that rivalry continues to discipline the commercial behaviour of the merged entity and put pressure on all providers to continue to improve their offerings to customers and/or become more efficient or innovative. All the more so as, for the reasons set out in detail in Section D of BT's Initial Submission, BT (as an MVNO) would not have had any special advantages in the market. Indeed, BT would have been disadvantaged in comparison with MNOs and even, in some respects, other MVNOs.

(b) "Theory of harm 2" relates to the merged entity's alleged "greater capabilities" than the standalone EE would have had in the retail mobile market and whether any such "greater capabilities" would permanently weaken competition. Set against the backdrop of: the individual and aggregate competitive strength of existing MNO and MVNO providers, the fast-moving nature of the telecoms markets and the effectiveness of regulation, it is not plausible that the merger would result in the merged entity being able to offer non-replicable services, or otherwise having unmatchable advantages, either in the retail mobile market or in terms of cross-selling fixed and mobile services. Were the merged entity to have any "greater capabilities" than EE would have had absent the Transaction, they would allow the merged entity to enhance competition and to offer benefits to its retail mobile customers as a result of efficiency gains. Such efficiencies would also be rivalry-enhancing. In fact, the Transaction is likely to increase competition in the retail mobile market, by eliminating double marginalisation in relation to BT's incremental mobile sales and incentivising BT to cross-sell high-quality services at compelling price points, in competition with other providers with their own competitive strengths.

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[2] CC2/OFT1254, the *Merger Assessment Guidelines*, paragraph 4.1.3.

2.2 The remainder of this section is structured as follows:

(a) Part 3 deals with market definition;

(b) Part 4 deals with theory of harm 1; and

(c) Part 5 deals with theory of harm 2.

2.3 For reference, the remainder of this section sets out in italicised headings the various considerations outlined in the Issues Statement, to which the following paragraphs respond.

3. Market definition

3.1 As noted in the Issues Statement at paragraph 17, the Parties submit that the relevant product scope for the CMA's assessment is the market for retail mobile telecommunications services (referred to below as the ***retail mobile market***). This is the market on which MNOs and MVNOs sell voice and data services to end customers via a mobile network.

3.2 The Parties submit that this definition of the market, which has been consistently applied by the Commission, remains the appropriate analytical framework for the CMA's review.[3] In any event, in the present case, the exact definition of the product market can be left open by the CMA, as the Transaction does not raise any competition concern under any plausible market definition.

3.3 Paragraph 16 of the Issues Statement goes on to note that 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)."

3.4 The Parties submit that there can be no SLC (in the UK as a whole or regionally) regardless of whether the CMA takes horizontal overlaps in these other "segments" into account, because these horizontal overlaps are negligible.

3.5 Paragraph 18 of the Issues Statement states that the CMA "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". The CMA indicates that this may include a number of specific considerations, which the Parties address in turn.

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[3] Case *COMP/M.5650 T-Mobile/Orange*: see paragraphs 20-24. Case COMP/M.6497 *Hutchison 3G Austria/Orange Austria*: see paragraphs 30-58. Case COMP/M.6992 *Hutchison 3G UK/Telefonica Ireland:* see paragraphs 141-154. Case COMP/M.7018 *Telefónica Deutschland / E-Plus*: see paragraphs 26-71.

"the extent to which business and domestic customers should be considered separately"

3.6 The Parties consider that the conditions of competition for business and domestic customers, particularly given supply-side considerations, are not sufficiently different as to form distinct markets. The European Commission has consistently taken the same approach, for example in *T-Mobile/Orange,*[4] *Hutchison 3G UK/Telefonica Ireland*[5] and *Telefónica Deutschland/E-Plus.*[6]

3.7 Moreover, business customers often purchase consumer tariffs for mobile services, particularly if the business in question is small. This makes it difficult for MNOs to identify exactly who are business customers and who are consumers. In this respect, the Parties are unable to quantify the number of their customers who take "consumer" mobile propositions for business purposes.

"the extent to which there may be sub-markets for 4G mobile services or for users consuming high levels of data"

3.8 No such "sub-markets" exist for 4G mobile services, or for users consuming high levels of data. These two putative "sub-markets" are dealt with in turn below.

There is not a "sub-market" for 4G mobile services

3.9 For the purpose of market definition, no UK or EU precedent has considered separate markets for different data speeds or generations of mobile technology.[7] Instead, all precedents have defined a single retail mobile market and the Parties see no factual basis for the CMA to depart from that approach in this case. These findings have been based on, among others, the following factors:

(a) MNOs are able to provide different technologies to supply voice, SMS and data services. For example, voice services are currently provided using 2G and 3G technologies, and will be provided using 4G once

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4 Paragraph 21.

5 Paragraphs 149-150.

6 Paragraphs 32-36.

7 The European Commission has considered this on a number of occasions – including in relation to the UK market, in *T-Mobile/Orange,* paragraph 24; and very recently, in *Telefónica Deutschland/E-Plus,* paragraphs 45-50 – and found that there is a single retail market incorporating all technologies. Ofcom has also considered this in its *Decision to vary Everything Everywhere's 1800 MHz spectrum licences to allow use of LTE and WiMax technologies*, published August 2012: http://stakeholders.ofcom.org.uk/binaries/consultations/variation-900-1800mhz-lte-wimax/statement/statement.pdf; and its *Communications Market Report 2014,* published August 2014: http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr14/UK_5.pdf, Section 5.1.2.

VoLTE is launched,[8] whilst data services are typically provided using 3G and 4G technologies.

(b) In practice, mobile customers use different mobile technologies in parallel as they move around the mobile network. Furthermore, there are no 4G-only mobile operators; all operators use a mix of technologies to deliver services. For example, a subscriber with a 4G device and subscription may use 2G, 3G and 4G services at different times in the same day as they move around the network and in and out of 4G coverage. Equally, a subscriber with a 3G device may use both 3G and 2G services.

3.10 At present, because of the above factors, retail mobile tariffs that use 2G and 3G technology (but not 4G technology) constrain tariffs that include 4G. Customers are able to choose between 4G and non-4G tariffs to find one that offers them the best balance between cost and the quality advantage of newer technologies. This demand side substitution between 4G and non-4G tariffs is significantly enhanced by the fact that any mobile customer can, in any event, make use of fixed broadband connections via WiFi to receive fast internet connectivity – irrespective of the provider of those fixed connections – in particular when at home or in the office (see also paragraph 3.17 below).

3.11 There is also a high degree of supply-side substitutability, since all MNOs are able to offer 2G and 3G technologies throughout the UK and 4G technologies to the majority of the UK population, with the geographic scope of each MNO's 4G coverage continuing to increase.

3.12 Moreover, the UK retail mobile market is moving towards inclusion of 4G in retail mobile tariffs as standard. It is likely that all MNOs and most MVNOs will move to a model whereby they only offer tariffs that include 4G. This is not least because 4G technology is more efficient than 2G and 3G technology and so all operators will want their customers to migrate to 4G technology over time (which will also allow the MNOs to clear 2G and 3G spectrum bands to be refarmed for 4G). Many MVNOs are already offering 4G services to customers, or have announced plans to do so in the near future (see further Part 9 below).

There is not a "sub-market" for users consuming high levels of data

3.13 The cellular data consumption of any given user is typically moderated (or capped) by the data allowance that is included on that user's tariff. Tariffs that offer lower data allowances constrain those that offer higher, or even unlimited, data allowances.

3.14 On the supply-side, both MNOs and MVNOs are able to offer competitive tariffs to customers wanting high data volumes. H3G, TalkTalk and GiffGaff also offer "unlimited" data bundles, demonstrating that this is possible either as an MNO or an MVNO. Indeed, TalkTalk is currently offering unlimited

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[8] VoLTE is expected to launch in the UK in the course of 2015, see for example http://telecoms.com/407351/vodafone-uk-to-launch-wifi-calling-and-volte-this-summer/.

voice minutes, texts and data for just £12 per month (to existing/new customers who take a fixed voice and broadband proposition).[9] Further examples of SIM-only tariffs currently offered by MVNOs with data bundles of 4GB or more include the following:[10]

Figure 1: SIM-only tariffs offered by MVNOs with ≥4GB data

Operator	Voice Mins	Texts	Data	3G/4G	MRC
GiffGaff	2,000	unlimited	unlimited	3G	£20.00
GiffGaff	1,000	unlimited	5GB	4G	£18.00
iD Mobile	2,000	5,000	10GB	4G	£20.00
Lycamobile	2,000	unlimited	5GB	4G	£17.00
TalkTalk[11]	unlimited	unlimited	unlimited	3G*	£12.00
Post Office	1,000	3,000	5GB	3G*	£20.00
Tesco Mobile	5,000	5,000	8GB	4G	£24.50
Virgin Media	unlimited	unlimited	8GB	3G	£23.00

* Although the Post Office and TalkTalk currently only offer 3G tariffs, they have announced that they will soon offer 4G tariffs. [✂]

3.15 In practice, few users consume genuinely "high" levels of cellular data. All MNOs and MVNOs (even those with more limited capacity, or higher variable network costs) can therefore safely (in economic terms) offer tariffs with high data allowances. [✂]

3.16 A customer may also opt for a cheaper tariff (with a lower data allowance) if that tariff allows them to purchase additional data allowances as needed (on either a pay as you go basis, or in blocks of additional data).[12]

3.17 Even customers who make heavy use of data on mobile devices do not necessarily require large data bundles in order to meet their needs. Users are already in the habit of using private WiFi connections (in particular those in their homes and offices) to "offload" data usage on mobile devices when indoors, rather than using the allowance for cellular data provided as part of

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9 As noted by Enders Analysis, in its report "*TalkTalk Group Q1 2015/16 results: Work in progress*", TalkTalk's tariffs are "very competitive, particularly on data allowance".

10 SIM-only tariffs are compared here to aid straightforward comparison, but the Parties note that both handset propositions and pay as you go tariffs should also be considered by the CMA.

11 As noted above, this tariff from TalkTalk requires the customer to also purchase a fixed line/broadband package from TalkTalk, or be an existing fixed line/broadband customer.

12 For example, EE currently offers one-off data add-ons of up to 10GB to its 4G customers: http://ee.co.uk/help/add-ons-benefits-and-plans/calling-texting-and-data-add-ons/ee-pay-as-you-go-add-ons/ee-pay-as-you-go-phone-data-add-ons.

their tariff (indeed, it is often automatic as devices are programmed to switch to WiFi networks when they come into range).[13] Any customer can use fixed connections – irrespective of the provider of those fixed connections – to offload data traffic.[14] Mobile tariffs with lower data allowances therefore constrain mobile tariffs with higher data allowances.

"*the extent to which the market for mobile/fixed bundles can be considered as a separate market to unbundled offers, and within a bundled segment which includes pay-TV, whether there are further distinctions based on the TV services offered*"

3.18 At present, there is no separate market for fixed-mobile bundles in the UK. Only a very small percentage of customers purchase retail mobile services as part of a single bundle or contract with fixed services. Ofcom's research suggests that in the UK, 95% of consumers purchase mobile telecoms as a standalone service, rather than as part of a bundle of products from a provider, "which suggests [mobile] continues to be purchased at an individual rather than a household level."[15] The purchasing cycle for mobile contracts is also different to that of fixed services such as broadband, as it is driven by factors such as new handset launches.

3.19 In the context of household purchases, providers such as Sky, TalkTalk and Virgin Media have cross-sold TV with fixed broadband and fixed voice services for a number of years without the emergence of a separate "triple-play" market.[16] In part, this is because of the importance of content to consumers, which may encourage consumers to "unpick" bundles. As recognised by Ofcom, "within the bundle, consumer research indicates that for some consumers content is viewed as an important driver of consumer purchasing decisions".[17]

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[13] See paragraph 4.25 of BT's Initial Submission and BT's response to Q2(h) of MQ1.

[14] Cisco suggest that close to 80% of mobile data usage is indoor and nomadic, rather than truly mobile, with the vast majority of that data offloaded to WiFi, *Cisco Service Provider Wi-Fi: A Platform for Business Innovation and Revenue Generation*, http://www.cisco.com/c/en/us/solutions/collateral/service-provider/service-provider-wi-fi/solution_overview_c22-642482.pdf. See also Enders Analysis *UK Mobile User Survey 2014,* page 21, which notes that "85% of smartphone users offload data activities onto WiFi networks at home or at their place of work, with the figure no doubt higher if including under 16s". BT estimates that, at present, around [80-90%] of mobile data traffic in the UK is offloaded to WiFi.

[15] Ofcom Research Report, *The Consumer Experience of 2014*, published January 2015: http://stakeholders.ofcom.org.uk/binaries/research/consumer-experience/tce-14/TCE14_research_report.pdf.

[16] Neither Ofcom, nor any relevant competition authority (whether the OFT/CC, CMA or Commission), has defined a distinct market in the UK for "triple-play" services, combining fixed voice, fixed broadband and pay-TV services.

[17] Ofcom's *Strategic Review of Digital Communications "Discussion Document"*, paragraph 8.35: http://stakeholders.ofcom.org.uk/binaries/consultations/dcr_discussion/summary/digital-comms-review.pdf.

3.20 Taken together, the factors noted in 3.18 and 3.19 above undermine any claim about the existence or imminent emergence of a separate UK "quad-play" market combining all four of fixed voice, fixed broadband, retail mobile and pay-TV services. The emergence of any such market would require that both sets of difficulties outlined above are overcome: the difficulty in aligning household purchasing decisions relating to fixed voice, broadband and pay-TV (where content is often key) and the difficulty of convincing a customer to make their "individual" purchase of mobile services from the same provider from which they also purchase "household" fixed services. Unsurprisingly therefore, Ofcom's discussion document for its Strategic Review of Digital Communications notes that take-up of quad-play has so far been limited to 2% of households.[18]

3.21 In respect of "quad-play", European comparators are not indicative of likely UK trends. Examples of successful "quad-play" entry in other markets has depended on offering cheap mobile deals to add to a "triple-play" bundle. For example, Free in France was able to achieve some success with this strategy. However, in the UK retail mobile market, margins are lower and so there is not the same opportunity. It is noteworthy that retail mobile margins following Free's entry in France were still higher than those in the UK.

3.22 Moreover, were any such "quad-play" market to emerge in the future, a number of providers can already – or will soon be able to – provide fixed-mobile bundles to "quad-play" customers, such as Sky, Virgin Media, TalkTalk and Vodafone (which has recently launched its fixed voice and broadband proposition and has announced it will launch pay TV services in autumn 2015). All of these competitors have – or will have – opportunities to co-sell and cross-sell fixed and mobile products similar to that of the merged entity. In particular, each of them has a large existing customer base into which new propositions can be cross-sold. BT would be a new entrant into this (putative) market, both as an MVNO (in the counterfactual) and following the Transaction. Furthermore, the Transaction would not create or enhance any existing barriers to existing providers' or new entrants' ability to serve customers who purchase quad-play services.

3.23 As noted in Section D, paragraph 4.61 of BT's Initial Submission, while BT expects to generate incremental revenue from selling cross-sold and bundled services to BT's and EE's respective existing customer bases for both consumers and business customers, the projected magnitude of these synergies is relatively modest and does not reflect any BT expectation of a significant change in customers' appetites for purchasing fixed and mobile services together. However, to the extent customers appreciate the ability to consolidate their purchasing power and harness the benefits of one stop shopping for fixed-mobile bundles, BT will be able to offer competitive propositions. As such, the revenue synergies BT hopes to achieve as a result of the Transaction are consistent with the above analysis.

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[18] Ofcom's *Strategic Review of Digital Communications "Discussion Document"* paragraph 4.76.

3.24 In addition, to the extent that fixed-mobile bundles include pay-TV, the Parties note that BT and EE have a small combined share of the pay-TV market of around 6%, with an increment to BT's share of less than 1%.[19] Sky and Virgin, in contrast, have considerably higher shares.

"*the extent to which there may be other markets which should be considered separately (for example, SIM-only)*"

3.25 On the supply-side, the mobile services provided for SIM-only customers are the same as for pay monthly contracts that include a handset and pay as you go tariffs (which can often be bought with or without handsets included). All MNOs and the vast majority (if not all) MVNOs offer SIM-only deals. EE offers a range of propositions of different types (e.g. SIM-only, handsets and pay-as-you-go) whilst BT offers SIM-only to both business customers and consumers, as well as pay-monthly offers including handsets to business customers. [✂]

3.26 On the demand-side, SIM-only tariffs face close competition both from pay monthly contracts that include a handset and from pay as you go tariffs.

3.27 The Parties consider that, in addition to these factors, in order to reach a firm conclusion on the appropriate scope of the market definition for retail mobile services, it would be necessary to also take account of the competitive pressure exerted by providers of over-the-top (***OTT***) services, which constrain mobile operators in relation to voice and text services. MNOs and MVNOs observe a strong substitution between traditional mobile voice and messaging services and OTT services.[20] These OTT services also allow data-only SIMs[21] to perform similar functions to SIM cards that can be used for the full range of mobile services, as they allow for voice calls using voice over IP (***VoIP***) or video calling, as well as OTT messaging services. Enders Analysis reports that 83% of smartphone users make use of OTT communications services on a daily basis.[22]

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

4.1 This theory of harm is outlined in paragraphs 50 and 51 of the Issues Statement:

"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

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[19] Sources: Company results / 3 Reasons LLP / Enders Analysis / M&CI Team Estimates.

[20] EE has provided Ofcom with detailed views on this point as part of Ofcom's Mobile call termination market review. The non-confidential version of EE's response to Ofcom's consultation, dated August 2014, is available here: http://stakeholders.ofcom.org.uk/binaries/consultations/mobile-call-termination-14/responses/Everything_Everywhere.pdf.

[21] SIM cards that only provide access to the internet for "mobile data" use, but not the ability to make and receive calls, or text or multimedia messages (SMS/MMS) to a specific mobile number. These data-only SIMs are sometimes referred to as "mobile broadband" services.

[22] Enders Analysis research report, *UK Mobile User Survey 2014,* published January 2015.

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

"In assessing these concerns, [the CMA] will consider, as compared to the counterfactual:

(a) *the extent to which BT would have exercised a significant constraint on EE; and*

(b) *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."*

4.2 This theory of harm relates to the loss of potential competition that would arise as a result of the Transaction removing BT as an independent MVNO on the retail mobile market. In response to paragraph 51(a) of the Issues Statement, as set out in Section D of BT's Initial Submission and in particular paragraphs 4.1 to 4.54, BT would not have had any substantial special advantages as an MVNO. In response to paragraph 51(b) of the Issues Statement, the Parties submit that the merged entity will continue to be constrained by strong competition from the other MNOs and a range of strong MVNOs, including Virgin Media, Sky and TalkTalk (see further Part 5 below). As a result, the merged entity will not be able profitably to degrade service or increase its prices.

4.3 Paragraph 52 of the Issues Statement lists a number of issues that the CMA is "likely to investigate" as part of the inquiry (the first considering the degree of competition in the market as a whole, the others considering the "likely constraint from BT, without the merger"). All of these issues have been considered in detail by the Parties in previous submissions and therefore the Parties provide below only an outline response to each point, alongside cross-references to the sections in those responses that set out further details.

"*the current degree of competition between MNOs and MVNOs*"

4.4 The retail mobile market is highly competitive, with MNOs and MVNOs all competing strongly for customers.[23]

4.5 The UK MNOs are also active wholesalers, with all four MNOs hosting a number of MVNOs on their networks.[24] As a result, more than 100 MVNOs compete in the retail mobile market, accounting for a market share of approximately 15% of UK mobile subscribers.[25] These include powerful

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[23] The current degree of competition in the market is considered in further detail in Sections 5 and 6 of Annex J of the Merger Notice.

[24] Further submissions on the wholesale market are set out in Section C.

[25] As per Ofcom's *Infrastructure Report 2014*, published December 2014: http://stakeholders.ofcom.org.uk/binaries/research/infrastructure/2014/infrastructure-14.pdf, "MNOs have reported a total of 41 direct MVNO customers. Most of these MVNOs provide a

brand names such as Asda, TalkTalk, Tesco, Virgin and the Post Office. Furthermore, there is frequently new entry into the retail market by MVNOs.[26] Following its entry as an MVNO in 2016, Sky will also be likely to compete strongly and TalkTalk has announced enhanced mobile ambitions.[27]

"the impact of BT on the retail mobile market";

4.6 As an MVNO, BT expected to make a modest impact on the retail mobile market. If it was able to meet its ambitions, it would have achieved a [0-5%] market share in the second year of marketing its renewed consumer mobile propositions. However, EE's internal assessments notably indicate that [✂].

4.7 The evolution of BT's ambitions regarding the retail mobile market are described in BT's supplementary response to question 2(a) of MQ1.

"*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*";

4.8 As set out in detail in Section D of BT's Initial Submission, BT's perceived "strengths" cannot be expected to have given it any substantial special advantages as an MVNO (see in particular paragraphs 4.1 to 4.54). In summary, BT's ability to cross-sell from fixed markets is likely to have a limited impact on the mobile market, given consumers' preference to purchase mobile services separately (see paragraph 3.18 above) and in any case is not unique. The Transaction is also rivalry enhancing in that it enables the Parties to compete more effectively with established cross-sellers, such as Virgin Media, Vodafone and TalkTalk. BT's spectrum would not give it a significant special advantage, for reasons set out in BT's previous submissions. Moreover, the femtocell proposition (or its benefits) that BT is aiming to deploy to utilise its spectrum is replicable by other providers. BT's other assets cannot be expected to give it any substantial special advantage.

4.9 Furthermore, as set out in relation to wholesale fixed and broadband services, (see 16.19), other providers can gain access to BT's regulated inputs for the supply of fixed broadband and fixed voice services. As such, those aspects of BT's propositions are replicable by other providers.

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similar service of voice, SMS and data, though some are more specialised." MVNO market share based on *Ovum MVNO Forecast*, 2014.

26 For details of MVNO entry over time, see Piran Partners, *MVNO Observatory, Annual Report on the UK Market, Spring 2014*, available at: http://www2.piranpartners.com/component/joomdoc/doc_download/24-piran-partners-mvno-observatory-spring-2014.html.

27 Sky announced in January 2015 that it has entered into an MVNO arrangement with O2, "to add a range of mobile voice and data services to its customer offering for the first time": https://corporate.sky.com/media-centre/news-page/2015/sky-announces-plans-to-enter-mobile-sector. TalkTalk announced in November 2014 that it has entered into an MVNO arrangement with O2, as "a major step forward in our long term strategy to build a small cell and Fibre-To-The-Premise network. Coupled with our own in-home 4G spectrum and 4m points of presence this will create a powerful opportunity for us to offer seamless, low cost connectivity to our customers." http://www.talktalkgroup.com/press/press-releases/2014/telefonica-talktalk-17-nov-2014.aspx.

4.10 As set out in Section D, paragraphs 4.34 to 4.48 of the Initial Submission, in certain respects BT is actually disadvantaged as compared with MNOs and, potentially, other MVNOs. This includes the fact that BT (as an MVNO) [✂].

4.11 As detailed in Section D, paragraphs 4.10 to 4.33 of the Initial Submission, BT is also taking a significant risk pursuing its femtocell strategy. [✂]The benefits of femtocells (as well as the use of femtocells themselves) are replicable by MNOs and MVNOs, including through deployment of solutions less complex than BT's [✂]. Furthermore, the availability of WiFi and voice over WiFi (***VoWiFi***) technology will allow other providers to substantially replicate the benefits of femtocells without the need to invest in spectrum or the deployment of femtocell technology.

"*trends, including the demand for data and fixed-mobile bundles*";

4.12 While demand for mobile data is growing, all MNOs are well served by their current spectrum holdings and will be for the short to medium term.[28] In addition, there are a number of opportunities open to MNOs to expand their network capacity to meet the growing mobile data demand, with or without access to additional spectrum, such as technological advancements and the release of further spectrum.

4.13 By contrast, to date there has been little to suggest increasing levels of distinct demand in the UK for fixed-mobile bundles. As noted above, Ofcom has observed that 95% of consumers purchase mobile telecoms as a standalone service, rather than as part of a bundle of products from a provider. This reflects the fact that mobile services are purchased "individually", rather than for the "household" (unlike fixed services).

4.14 Even if demand for fixed-mobile bundles increases, the merger is rivalry enhancing, as it will allow the merged entity to compete more effectively with established providers of fixed-mobile bundles, such as Virgin Media, Vodafone and TalkTalk, and has the potential to attract other competitors, such as Sky, to commit to competing in such propositions.

4.15 Further information on these trends are set out in Sections B and D of BT's Initial Submission.

"*capacity constraints and their impact on competition*";

4.16 As set out in Section D, paragraph 4.53 of BT's Initial Submission, whilst the Parties do not consider that any of the MNOs are capacity constrained (or will be in the short to medium term), there are a number of options available to MNOs to increase network coverage and capacity. This includes options for

[28] This is supported by Ofcom's proposals for the upcoming auction. See Ofcom's consultation on the *Public Sector Spectrum Release (PSSR): Award of the 2.3 GHz and 3.4 GHz bands,* published 7 November 2014, paragraph 7.90. Ofcom considered that even if O2 and H3G (the MNOs with the least spectrum by volume) do not acquire additional spectrum, "they are both likely to have suitable spectrum to remain credible national wholesalers, especially in the short and medium term."

the MNOs even if they do not want to acquire more spectrum from Qualcomm or at the prevailing price at Ofcom's upcoming auction.

"*the impact of future spectrum releases*".

4.17 To the extent that MNOs consider that they do want additional spectrum (or MVNOs would like to purchase spectrum, as BT did in the 4G auction) a substantial amount will soon become available. This is considered further in Section D, paragraph 4.53 of BT's Initial Submission.

Conclusion on theory of harm 1

4.18 It is not credible that the loss of BT as an independent MVNO would have a significant adverse effect on rivalry within the retail mobile market over time so as to significantly decrease the competitive pressure between providers.

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

5.1 This theory of harm is set out in detail in paragraph 54 of the Issues Statement:

"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."

5.2 In considering whether this putative theory of harm could give rise to a genuine concern, the Issues Statement notes at paragraph 55 that "any improvements in EE's offer might be viewed as efficiencies and of potential benefit to consumers" and that therefore "[the CMA] 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".

5.3 If the merged entity were to have greater capabilities than the standalone EE would have had absent the Transaction, the Parties consider that these greater capabilities allow the merged entity to enhance competition and to offer benefits to its retail mobile customers as a result of the efficiency gains and an increased ability to innovate. This would be rivalry-enhancing. However, as explained below, any such putative capabilities would not be substantial or long-lasting and would certainly not be so substantial that they would "lead to other operators being less able to compete (than in the counterfactual)" or allow the merged entity to "set higher prices or lower quality in the longer term". Indeed, the constraint exerted by other MNOs and MVNOs together will prevent the merged entity from "degrading its service" in this way, relative to the counterfactual (as per paragraph 51(b) of the Issues Statement). Furthermore, any "greater capabilities" would need to be genuinely Transaction-specific and not, in fact, advantages that EE has as a result of its past investments to serve the retail mobile market.

5.4 The factors that the Issues Statement lists as "potential advantages of the merged entity over EE absent the merger" have been considered by the Parties

in previous submissions to the CMA. As such, the Parties provide below cross-references to the sections in those responses that set out further details.

"*the amount or type of spectrum held*";

5.5 The potential consequences for the merged entity of combining BT and EE's spectrum holdings are considered in detail in Q20 of RFI 2 and Q8(b) of EE's response to the Market Questionnaire.

5.6 [✂] Nonetheless, as explained in Section D, paragraphs 4.30 to 4.33 of BT's Initial Submission the merged entity's femtocell proposition would be replicable by other MNOs or MVNOs, including through strategies less complex than BT's [✂]. In addition, the benefits BT hopes to secure for itself through its femtocell strategy are substantially replicable by MNOs or MVNOs: see Section D, paragraphs 4.45 to 4.48 of BT's Initial Submission.

5.7 The MNOs' spectrum holdings are a result of their past strategic decisions (including in Ofcom's 2013 auction of 800 MHz and 2.6 GHz spectrum – the ***4G auction***). As per paragraph 55 of the Issues Statement, the CMA's assessment of the Transaction should not aim to protect mobile operators who "fail to invest and innovate", nor should the CMA intervene on the basis of competitive advantages relating to the merged entity's spectrum holdings which are not merger specific.

5.8 If other MNOs consider that they require spectrum in addition to their current holdings, they will be able to purchase more in Ofcom's upcoming auction of 2.3 GHz and 3.4 GHz spectrum, or from Qualcomm in its sale of 1.4 GHz spectrum (which is currently underway). It is expected that all of this spectrum will be used to provide 4G mobile services and each band would be well suited for small cell applications, which could substantially replicate BT's small cell propositions. These bands could also be utilised in the macrocell layer of an MNO's network. As a result, any perceived advantage that the merged entity would have in respect of the total volume of spectrum it will hold as a result of the merger would not be long-lasting if others choose to purchase spectrum at auction.

"*access to BT's WiFi hotspots and/or other network sites*";

5.9 BT would not expect its WiFi network to provide BT (as an MVNO, absent the Transaction) any significant advantage in the retail mobile market. Indeed, whilst BT offers a wholesale "WiFi offload" service to MNOs, [✂]. For the same reasons, the Parties would also not expect access to BT's WiFi hotspots to give the merged entity (post-Transaction) any significant advantage.

5.10 The vast majority of WiFi use on mobile devices is at a user's home or office and, as such, is provided as part of the fixed broadband service provided to that customer (or their employer). The availability of that fixed connection for WiFi "offload" does not depend on the provider of the fixed connection also providing the customer's mobile services; in fact, the broadband provider is typically not also the mobile provider. Because of this, any WiFi hotspot will provide an offload benefit to both the MNO/MVNO that provides that customer's mobile services and the customer themselves. BT's network of

WiFi hotspots includes both public WiFi hotspots and residential and business hotspots. The scale of BT's network of public WiFi hotspots (at around 10,100) is smaller than that of other providers of WiFi hotspots. Furthermore, the amount of traffic that goes through BT's residential and business hotspots is extremely small, compared with the amount offloaded into users' own homes and offices. [✂]

5.11 As set out in BT's response to Q9 of MQ1, BT would similarly not expect its network sites to provide it with a significant advantage in the retail mobile market.

"access to backhaul on improved terms";

5.12 As set out in Section D, para. 13.2 the merged entity will not have access to backhaul on terms that are substantially improved as compared to EE in the counterfactual.

"*increased opportunities for cross selling and bundling*".

5.13 BT hopes to achieve [✂] revenue synergies from cross-selling. However, this must be seen in the context of the low consumer demand for fixed-mobile bundles in the UK (as noted above).

5.14 As explained in Section D, paragraphs 4.49 to 4.52 of BT's Initial Submission, BT's ability to cross-sell will not give it a substantial special advantage over other providers. This is especially true given the number of other large scale providers that are – or in the near future will be – able substantially to replicate the bundled propositions that the merged entity would be able to offer (for example, Virgin, TalkTalk, Sky and Vodafone). Some of these providers, including Sky and TalkTalk (both of whom have a strong track record of effective cross-selling of products to their customer bases), will also be able to make use of cross-selling opportunities that are similar to those of the merged entity.

5.15 Furthermore, as set out in Section D, paragraph 4.57 of BT's Initial Submission, the Transaction will increase BT's incentive to price standalone products more keenly to increase its customer base, and therefore increase the scope for cross-selling complementary products. This incentive will grow in strength in the event that consumer appetite for bundles grows. This reflects a rivalry-enhancing efficiency, with clear benefits for customers.

5.16 This is in addition to the fact that the Transaction will eliminate double marginalisation in relation to BT's incremental mobile sales, providing the merged entity with a stronger incentive to price those additional sales more keenly.

Conclusion on theory of harm 2

5.17 It is not credible that competitors could be "permanently weakened" by the Transaction, nor that the merged entity will have "potential advantages" enabling it to exploit consumers. This is a very high standard and evidence has not been advanced by third parties to suggest that they would, in fact, be weakened. In fact, the complementary nature of the transaction creates a

unique opportunity to stimulate competition in the future including in areas where the UK is lagging behind such as in convergent services.

5.18 The ability of the merged entity to innovate in the retail mobile market may be increased as a result of the Transaction, whilst the competitive nature of the retail mobile market means that any efficiencies generated (including through any innovation, as well as through cross-selling and the elimination of double marginalisation) will be passed through to final customers.

Section C - Wholesale mobile

6. Introduction and summary

6.1 The Issues Statement sets out a concern that the merged entity would have the ability and incentives 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. In particular, the CMA states that 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;[29] and/or

(b) in the future, restrict or degrade the supply of wholesale mobile to other suppliers of fixed-mobile services, including Virgin Media, by not bidding or bidding less competitively for future contracts to supply them.[30]

6.2 It should be noted at the outset that the Transaction has no impact whatsoever on EE's ability to foreclose Virgin Media or other suppliers of fixed-mobile services, since it does not affect the number of MNOs. Rather, these theories of harm rest on an assumption (which the Parties contest) that EE has an ability to foreclose pre-merger but has no incentive to do so, and that the merger would create incentives to foreclose which would not otherwise exist.

6.3 The theories of harm identified by the CMA depend on a number of separate speculative possibilities all of which must be satisfied for a potential concern to arise. None of these speculative possibilities are likely to eventuate. For the reasons summarised below, the Parties do not consider that the elements necessary for a SLC based on input foreclosure concerns can be shown to exist in this case.

(a) The merged entity will not have an ability to degrade[31] the wholesale mobile services received by Virgin Media under the terms of its existing MVNO contract with EE.

(b) The merged entity will also not have an ability to restrict or degrade the services received by MVNOs offering fixed-mobile services under their future contracts, as those MVNOs would continue to be able to secure competitive wholesale terms from other MNOs through running a competitive tender process, even if the merged entity were not to bid.

(c) Given the lack of any ability to foreclose, the merged entity will have the same incentives to offer wholesale mobile access to all MVNOs as EE has shown to date.

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[29] Issues Statement, paragraph 57(a).

[30] Issues Statement, paragraph 57(b).

[31] Note, in the remainder of this response references to a hypothetical "degradation of services" includes both an increase in costs and/or a degradation of quality.

(d) In particular, the merged entity's position in the fixed market will not materially change its incentives (compared to EE's pre-merger incentives) to offer wholesale mobile services to those MVNOs who offer fixed-mobile services. This is because an increase in the retail price or a degradation in the quality of the mobile services which such MVNOs can offer would not be expected to lead to material switching of those MVNOs' fixed customers (even if those customers did switch their mobile contracts).

(e) There would, therefore, be insufficient incremental margin available to the merged entity as a result of a foreclosure strategy, as compared to EE's position absent the merger, to give rise to a material change in incentives.

6.4 The remainder of this section is structured as follows:

(a) Part 7 deals with market definition;

(b) Part 8 deals with the CMA's theory of harm concerning the existing MVNO contract between EE and Virgin Media; and

(c) Part 9 deals with the CMA's theory of harm concerning future contracts to supply fixed-mobile providers.

7. Market definition

7.1 As noted in the Issues Statement at paragraph 21, the Parties submit that the relevant product scope for the CMA's assessment is the wholesale market for the provision of access and call origination on mobile networks to MVNOs (referred to below as the ***wholesale mobile market***).

7.2 The Parties submit that this definition of the market, which has consistently been applied by the Commission, remains appropriate as an analytical basis for the CMA's review.[32] In any event, in the present case, the exact definition of the product market can be left open by the CMA, as the Transaction does not raise any competition concern under any plausible market definition.

7.3 Paragraph 23 of the Issues Statement indicates that the CMA may consider the extent to which:

(a) different types of MVNOs may represent distinct customer segments; and

(b) there may be different markets for different technologies (2G, 3G, 4G and other).

7.4 For the reasons explained below, the Parties do not consider it appropriate to segment the wholesale mobile market, on either of these bases. However,

[32] Case COMP/M.5650 *T-Mobile/Orange*: see paragraphs 27-30. Case COMP/M.6497 *Hutchison 3G Austria/Orange Austria*: see paragraphs 59- 63. Case COMP/M.6992 *Hutchison 3G UK/Telefonica Ireland:* see paragraph 155-156. Case COMP/M.7018 *Telefónica Deutschland / E-Plus*: see paragraphs 76-79.

even if the CMA were to consider a narrower frame of reference this would not change the CMA's competitive assessment of the Transaction. This is, in particular, because all MNOs are able:

(a) to meet the wholesale requirements of all types of MVNOs; and

(b) to supply wholesale mobile services using all mobile technologies.

Different customer types

7.5 The Issues Statement refers to three potential segmentations of MVNOs which the CMA may consider:

(a) "light" / "full" MVNOs;

(b) MVNOs targeting specific customer segments; and

(c) MVNOs offering retail mobile services on a standalone basis / as part of a fixed-mobile bundle.

7.6 Whilst there are some differences in demand and supply depending on the type of model which a MVNO is seeking to operate (i.e. full or light), the Parties do not consider these sufficient to justify the definition of a separate market or segment. MVNOs can easily change their offerings and thereby switch to another model. In some cases, the migration to a new business model is already anticipated in the wholesale agreement ([✂]).

7.7 As set out below, the Parties do not consider it appropriate to draw any form of segmentation of the wholesale mobile market on the basis of the types of customers targeted by MVNOs or whether they intend to offer retail mobile services as part of a bundle, based on strong demand and supply-side substitutability.

Full and light MVNOs

7.8 From a demand-side perspective, all types of MVNOs require the same basic wholesale service - access to a host MNO's radio access network (***RAN***), which may be supplied either directly by the host MNO or indirectly by a mobile virtual network aggregator (***MVNA***).[33] In this respect, both full and light MVNO solutions provide exactly the same functionality and there is a high degree of substitutability between wholesale services for this element of the service.

7.9 Beyond RAN access there is some variation in the wholesale services which a MVNO will require depending on which operating model it wishes to pursue:[34]

(a) *Light MVNO*: the range of services required by a light MVNO will depend on its business model but may include international roaming

[33] MVNAs offer indirect wholesale access to their relevant host network to MVNOs.

[34] See further Appendix I2 to the Notification.

services, subscriber ID provisioning, value added services, and customer relationship management and billing systems.[35]

(b) *Full MVNO*: by contrast, full MVNOs which maintain their own core network infrastructure are unlikely to require a significant number of additional services. However, as part of setting up its mobile virtual network, a full MVNO will require its core network to be technically integrated with that of the host MNO. MVNAs generally will be unable to meet this requirement, meaning that only the MNOs are likely to be viable suppliers to full MVNOs.

7.10 The Parties do not consider that there are separate markets or segments for the provision of wholesale mobile services to full and light MVNOs, respectively, given the high degree of supply-side substitutability between MNOs, all of which are able to provide wholesale services to all types of MVNOs (see further Part 9 below). The Commission has examined the market for the provision of wholesale mobile services on a number of occasions and has not identified any distinct segments for light and full MVNOs.

7.11 In the context of the CMA's current investigation, which in relation to wholesale mobile services focuses on potential foreclosure of MVNOs which supply fixed-mobile bundles, it is relevant to note that there is also demand-side substitutability between light and full MVNO models. Some larger fixed-mobile MVNOs have, most recently, taken steps to move to the full MVNO model, including BT. However, a number of these operators have previously operated as light MVNOs for many years ([✂]).[36]

7.12 Full and light MVNOs compete with each other in the retail market, as well as with MNOs. This implies, in particular, that MNOs could not offer unattractive wholesale terms to full MVNOs as those MVNOs' retail customers could readily switch to one or the many light MVNOs as well as to other MNOs. Potential switching by retail customers between full and light MVNOs (and MNOs) therefore ensures that the wholesale terms offered to these two categories of MVNOs must be comparable.

Different target customer segments

7.13 As set out in the Notification, there are a number of categories of MVNOs currently operating in the UK based on the type of retail customers targeted by those MVNOs (e.g. B2B, ethnic).[37]

7.14 However, from a demand-side perspective, these categories of MVNO purchase access to identical wholesale mobile services (i.e. at a basic level,

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35 These additional services may either be supplied by the host MNO/MVNA or by a MVNE.

36 [✂]

37 See Annex I (*Wholesale mobile services*) to the Notification.

wholesale access to the RAN of a MNO in order to provide voice, SMS and data services).[38]

7.15 There is also strong supply-side substitutability, since there is no material difference for a MNO/MVNA in terms of the wholesale mobile services which are provided to MVNOs targeting different retail customer segments. MNO/MVNAs would be able readily to shift their resources to supply different MVNOs in response to a hypothetical price rise for wholesale mobile services to MVNOs targeting any particular retail customer segment.

7.16 There is therefore no basis on which separate customer segments within the wholesale mobile market should be considered, based on the type of retail customers targeted by MVNOs.

Standalone retail mobile services / fixed-mobile services

7.17 For the same reasons, there is also no basis on which a separate market or customer segment can be identified for MVNOs which offer retail mobile services as part of a fixed-mobile bundle.

7.18 From a demand-side perspective, the services required by a MVNO to offer a standalone retail mobile service are identical to those required to offer such services as part of a fixed-mobile bundle. This is because the retail mobile services offered by MVNOs which also provide fixed communications services do not differ from those offered by MVNOs selling only mobile services. The only relevant difference is the way in which these services are sold and marketed, which does not depend upon the underlying wholesale mobile services. In fact, many (if not all) fixed communications providers offer mobile as an additional service to their fixed customers on the basis of a separate contract.

7.19 As set out above, there is also strong supply-side substitutability in relation to the services provided to such MVNOs.

Different technologies

7.20 The Parties also do not consider that the wholesale mobile market can be split into different markets or segments for different mobile technologies (i.e. 2G, 3G, 4G and/or other future technologies). From a demand-side perspective, MVNOs' demand for wholesale mobile services is fundamentally driven by the demand of retail customers for retail mobile services. A separate market for any particular mobile technology could therefore only be derived at the wholesale level if there were a separate retail market for a particular mobile technology (e.g. 4G). As set out in Section B (Retail Mobile) of this response, the Parties do not consider that this is the case.

7.21 In practice wholesale mobile services are supplied by MNOs on the basis of multiple mobile technologies. These technologies are substitutable with each other at the wholesale level, not least because the technologies are

[38] Note, some MVNOs may only offer data services (see Annex I (*Wholesale Mobile Services*) of the Notification).

substitutable at the retail level of the market. There is also a high degree of supply-side substitutability, since all MNOs are able to offer 2G and 3G technologies throughout the UK and 4G technologies to the majority of the UK population, with the geographic scope of each MNO's 4G coverage continuing to increase.[39]

7.22 Over time, MNOs are expected to transition more of their traffic onto their respective 4G networks (which use spectrum in a more efficient manner). As this occurs, the traffic from MVNOs will also transition to 4G, as it would be inefficient for MNOs to maintain separate 2/3G networks just to host MVNOs. As supply contracts with MVNOs are renewed in the next 3-5 years, there will be increasing use of 4G by MVNO customers. It would therefore be inappropriate for the CMA to segment the market by reference to 2/3/4G technologies, given the migration between these technologies over time.

8. Theory of harm 3 – wholesale mobile – degradation of services provided to Virgin Media within existing contract

8.1 This Part focuses specifically on factors relevant to EE's supply of wholesale mobile services to Virgin Media under the existing MVNO agreement between EE and Virgin Media (the ***VM Agreement***).

8.2 The VM Agreement has a term lasting until [✂] (the ***Initial Term***).[40] As explained below, the merged entity will have no ability or increased incentive to degrade the services provided to Virgin Media during the VM Agreement.[41]

(a) The VM Agreement sets out [✂], meaning that the merged entity will have no ability to degrade the existing services received by Virgin Media.

(b) The VM Agreement provides for Virgin Media to [✂].

(c) Virgin Media will be able to exert significant countervailing buyer power against the merged entity, as the merged entity will be strongly incentivised to retain Virgin Media as a wholesale customer at the end of the Initial Term. Virgin Media is by far EE's largest wholesale customer, accounting for over [✂] of EE's wholesale revenues in 2014. As it has with EE in the past, this countervailing buyer power will constrain any incentive for the merged entity to degrade Virgin Media's wholesale services.

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39 The ability of MVNAs to offer 4G access depends on the terms of their wholesale arrangement with their host MNO.

40 [✂]

41 The Parties note that, whatever counterfactual the CMA ultimately determines is appropriate, this will have no impact on the merged entity's ability to degrade the services provided to Virgin Media under the VM Agreement. An alternative counterfactual would only affect the merged entity's incentives in relation to the VM Agreement if it reduced the likelihood of Virgin Media being able to switch to another MNO host at the end of the VM Agreement. For the reasons explained in Part 9 below, this is not the case.

(d) There will, furthermore, be no enhanced incentive for the merged entity to degrade the services provided to Virgin Media, since it is highly unlikely that such a degradation would lead to material switching by Virgin Media's fixed customers to the merged entity. Furthermore, [✂].

(e) [✂]

8.3 This merged entity's ability and incentives to foreclose Virgin Media following expiry of the Initial Term of the VM Agreement are addressed in Part 9 below.

No ability to degrade services under existing VM Agreement

8.4 The VM Agreement does not provide the merged entity with any ability to materially degrade the wholesale mobile services provided to Virgin Media. In particular:

(a) The VM Agreement sets out the charges to be paid by Virgin Media [✂].

(b) [✂][42] [✂][43]

(c) [✂][44] [✂][45]

(d) The merged entity will not have the ability to degrade the services currently provided to Virgin Media, as the VM Agreement requires EE [✂].

(e) EE is, furthermore, required to [✂].[46] [✂]

(f) [✂]

(g) [✂][47]

***No ability to obstruct* [✂]**

8.5 As explained in EE's response to the CMA's Market Questionnaire, the VM Agreement provides for [✂]. There is no ability for the merged entity to harm Virgin Media by [✂].

8.6 [✂][48]

8.7 [✂][49]

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42 [✂]

43 [✂]

44 [✂]

45 [✂]

46 [✂]

47 See further EE's response to question 18 of the CMA's Market Questionnaire.

48 Ibid.

8.8 [✂]

8.9 [✂][50] [✂]

8.10 [✂]

8.11 [✂]

(a) [✂]

(b) [✂]

(c) [✂]

No material change in incentives to degrade services during existing VM Agreement

8.12 Even if it were assumed that the merged entity would have the ability to increase the costs or degrade the quality of the wholesale mobile services that EE currently provides to Virgin Media, which the Parties contest, it will not have any increased incentive to do so as:

(a) This would make it highly likely that Virgin Media would choose an alternative MNO partner when the Initial Term of the VM Agreement expires in [✂], which would not be in the interests of the merged entity given the significance of Virgin Media as a wholesale customer of EE.

(b) In any event, there is no material change in incentive as a result of the merger as there is no evidence to suggest that degrading the mobile services provided to Virgin Media would result in material switching of Virgin Media's fixed customers to the merged entity.

(d) Furthermore, a [✂].

Virgin Media has significant countervailing buyer power

8.13 In considering the merged entity's hypothetical incentives to degrade the services provided to Virgin Media, it is important to take into account that, as by far EE's largest wholesale customer, Virgin Media will be able to exert significant countervailing buyer power against the merged entity.

8.14 In particular, the merged entity will be strongly incentivised to retain Virgin Media as a MVNO customer given the contribution which it makes to EE's revenues and profitability. In 2014, EE received wholesale revenue of over [✂] from Virgin Media, accounting for approximately [✂] of EE's total wholesale revenue, over [✂] of EE's overall revenue and approximately [✂][51] of EE's total EBITDA. [✂]

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49 [✂]

50 [✂]

51 [✂]

8.15 Virgin Media will, therefore, be able to use the threat of switching as leverage to constrain any attempt by the merged entity to degrade services or [✂]. Virgin Media will be able to switch to an alternative host from [✂]

8.16 Virgin Media's ability to switch (and to use switching as a credible threat) is, furthermore, not dependent upon [✂]. Indeed, Virgin Media has ([✂]) been able to use its ability to switch to constrain EE's behaviour and has significant leverage during contract negotiations. This includes, for example, in securing EE's agreement to [✂].

No material change in incentives arising from merged entity's position as a provider of fixed and mobile services

8.17 Even if it were assumed, which the Parties contest, that the merged entity would have an ability materially to degrade the services offered to Virgin Media, the only potential material difference in the merged entity's incentives to do so compared to the standalone EE is due to BT's provision of retail and wholesale fixed telecommunications services.

8.18 However, in relation to Virgin Media, there could only be a change in the merged entity's incentives to deal with Virgin Media if a significant proportion of Virgin Media's fixed (as well as mobile) customers were to switch to the merged entity or another retail fixed provider that purchases wholesale access to the merged entity's fixed network because of an increased cost or reduction in quality of Virgin Media's mobile service. This is highly unlikely because:

(a) EE estimates that only [✂] of Virgin Media mobile customers take both fixed and mobile services from Virgin Media.[52]

(b) Virgin Media's fixed telecommunications services are clearly differentiated from BT's and from other communications providers (***CPs***) that use BT's network. In particular:

(i) Virgin Media provides all its fixed customers with superfast broadband and very actively promotes the higher speeds that this offers compared to BT's superfast broadband. Virgin Media has reported that in Q1 2015 over 60% of its new subscribers chose products with speeds of 120 Mbps, speeds which cannot currently be matched on BT's network.[53]

(ii) Virgin Media's retail fixed customer churn is very low, indicating a high level of customer satisfaction with Virgin Media's fixed broadband services. Virgin Media's latest results report that "*customer loyalty has remained strong in the UK*

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[52] [✂]

[53] Virgin Media also reported that 36% of Virgin Media's fixed customers are now taking its top-tier internet services with speeds of 100 Mbps or higher. See http://www.libertyglobal.com/pdf/fixed-income/Virgin Media-Fixed-Income-Q1-2015-Release-FINAL.pdf.

where we have delivered another quarter of record low churn".[54]

(iii) Customers switching from cable to a CP using BT's network need to undertake a "cease and re-provide" process which requires them to contact both their current provider (Virgin Media) and new provider to arrange the new broadband service. This would provide Virgin Media a further opportunity to retain any fixed customers seeking to switch as a result of dissatisfaction with their mobile service (this compares to customers switching between CPs using BT's network, who need only contact their new provider (referred to as a "gaining provider led process")).[55]

(c) The most likely outcome of any degradation in quality or increase in cost of Virgin Media's mobile services sufficient to result in switching would be for affected consumers who purchase both fixed and mobile services from Virgin Media to terminate their Virgin Media mobile contract and to simply purchase their mobile service from an alternative supplier while continuing to take their fixed services from Virgin Media.

(d) This is because customers who purchase fixed-mobile "bundles" from Virgin Media do so by subscribing for a contract for fixed voice, broadband and/or TV services, and a separate SIM-only contract for mobile services as an "add-on". [56] As a result, a Virgin Media fixed-mobile customer can switch mobile provider without any impact on their fixed / TV services.

(e) Furthermore, survey data indicates that [✂] of Virgin Media broadband customers that do switch fixed provider switch to providers other than BT/EE, [✂].[57] This is likely because Sky is viewed as a closer substitute to Virgin Media due to the strength of Sky's Pay TV offering. The merged entity would stand to make a lower wholesale margin from such Virgin Media customers than if they switched to the merged entity. See also the factors set out at paragraph 9.42 below.

8.19 The merger would not give rise to a material change in incentives to foreclose. This is because a hypothetical degradation in service for Virgin Media would not result in a sufficient number of Virgin Media's fixed customers switching

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54 Ibid. Note, some of the churn experienced by Virgin Media is also due to customers moving home and out of the reach of Virgin Media's cable network. As such, Virgin Media's reported churn figures are therefore likely to overstate the number of customers which actively choose to change their fixed broadband provider.

55 See http://consumers.ofcom.org.uk/internet/broadband-switching/switching-broadband-provider/.

56 See http://store.virginmedia.com/virgin-media-mobile/sim-only/pay-monthly-sim.html.

57 [✂]

to the merged entity or another retail fixed provider that purchases wholesale access to the merged entity's fixed network.

***No material change in incentives to* [✂]**

8.20 Specifically in relation to [✂]

(a) [✂]

(b) [✂]

(i) [✂]

(ii) [✂]

(iii) [✂].

8.21 [✂]

(a) [✂]

(b) [✂]

(c) [✂]

(d) [✂]

(i) [✂][58]

(ii) [✂]

(e) [✂][59][✂] [60]

(f) [✂]

(g) [✂]

(i) [✂][61] [✂][62]

(ii) [✂][63] [✂]

(iii) [✂][64] [✂]

(iv) [✂][65]

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58 See Annex I (*Wholesale Mobile Services*) to the Notification, paragraph 6.18.

59 [✂]

60 See footnote 49 above.

61 [✂]

62 [✂]

63 [✂]

64 [✂]

65 [✂]

(v) [✂][66]

(vi) [✂]

(h) [✂]

8.22 [✂]

9. Theory of harm 3 – wholesale mobile – restriction or degradation of supply of services to suppliers of fixed-mobile services under future contracts

9.1 This Part focuses specifically on the merged entity's ability and incentives to degrade the supply of wholesale mobile services to suppliers of fixed-mobile services in general, through its approach to bidding for future MVNO contracts.

9.2 The Decision referred to TalkTalk and Sky as future potential customers that could potentially be affected by a foreclosure strategy, in addition to Virgin Media. This Part specifically addresses the CMA's theory of harm in relation to future contracts to supply TalkTalk and Sky.[67] [✂]

9.3 The obvious distinction between Virgin Media and TalkTalk and Sky is that the latter MVNOs are both supplied by O2 under existing contracts, entered into in 2014 and 2015 respectively, whereas Virgin Media is supplied by EE. EE expects that both the Sky and TalkTalk MVNO contracts will have terms lasting until around [✂]. EE's ability to affect rivalry as regards these MVNOs would only hypothetically arise when these contracts come up for renewal.

9.4 The Parties understand that both Sky and TalkTalk have entered full MVNO arrangements with O2, and would therefore also be seeking full MVNO arrangements upon contract renewal. [✂] Given the manner in which such arrangements are procured by MVNOs, the merged entity will have no ability to degrade the services which those MVNOs can ultimately secure. This is because, even if the merged entity refused to bid, each MVNO would retain the ability to secure a competitive outcome by conducting a tender process amongst the remaining MNOs, each of which will have the ability and strong incentives to bid aggressively to secure the relevant contracts.

9.5 Without an ability to foreclose, the merged entity will have the same incentives to bid for MVNO contracts as EE has today. In particular, it will operate in the knowledge that if it fails to bid for a contract, another equally capable MNO would offer the services and the merged entity would simply lose the wholesale margin and achieve no overriding benefit in the retail market.

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66 [✂]

67 The arguments made below would apply similarly to other fixed-mobile providers; smaller fixed-mobile providers seeking to operate on a light MVNO model would also be able to secure wholesale mobile services from MVNAs as well as the MNOs.

9.6 In particular, there will be no enhanced incentive for the merged entity to degrade the wholesale mobile services provided to fixed-mobile MVNOs, since it is highly unlikely that such a degradation would lead to material switching by those MVNOs' fixed customers to the merged entity.

No ability to restrict or degrade services through approach to future bidding opportunities

Sky and TalkTalk have announced full MVNO arrangements

9.7 The Parties understand that each of Sky and TalkTalk have full MVNO arrangements with O2, and would therefore be seeking a full MVNO arrangement when their current MVNO contracts come up for renewal. [✂][68]

(a) **TalkTalk / Sky**: [✂][69] [✂][70]

[✂][71] [✂]

The Parties do not have visibility of the MVNO arrangements which Sky and TalkTalk secured with their host MNO, O2. However, TalkTalk has publicly confirmed that it is a full MVNO, and that it intends to offer 4G femtocells using its guard band spectrum in the shared 1.8 GHz band.[72] The Parties also understand that Sky has adopted a model which will see it become a full MVNO.[73]

(b) [✂] [✂]

Each of the MNOs is able to deliver a full MVNO solution

9.8 As noted above (see Part 7 above), each of the MNOs has the ability to host full MVNOs. This is purely a matter of deploying the right technical resources in order to integrate the MNO's network infrastructure with the MVNO's core network. Indeed, once integrated with the host MNO's network, the range of wholesale services required by a full MVNO is less than that of a light MVNO.

9.9 The Parties would expect each of the MNOs to be in a position to be able to bid strongly for future contracts for MVNOs seeking full MVNO arrangements. In particular:

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68 [✂]

69 See further the parties' response to the CMA's RFI of 2 April 2015, question 7.

70 [✂]

71 [✂]

72 See http://www.fiercewireless.com/europe/story/talktalksigns-mvno-deal-telef-nica-uk-quad-play-push/2014-11-17.

73 See http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/telecoms/11376774/Sky-responds-to-BT-mobile-attack-with-O2-wholesale-deal.html.

(a) **O2**: O2 will be the incumbent host operator for both Sky and TalkTalk. Its network will therefore be integrated with Sky/TalkTalk's core networks and it will have a detailed knowledge and understanding of Sky/TalkTalk's requirements. [✂]

(b) **Vodafone**: To the Parties' knowledge, Vodafone does not currently host a full MVNO. However, there is no reason why Vodafone would be unable to in the future given that, like each other MNO, it has the required infrastructure.

The Parties note that Vodafone has, in response to TalkTalk's submissions, recently confirmed its commitment to the wholesale mobile market[74], reflecting its recent announcement of a partnership with Digitalk to provide a new MVNE platform.[75]

Furthermore, as noted in BT's initial Phase 2 submission, whilst Vodafone has seen a recent reduction in the number of MVNOs it hosts, this is primarily as a result of capability limitations that impacted its wholesale platform, Vodafone is two years into a substantial £6 billion three year programme of investment (Project Spring). As a result, Vodafone will be in a considerably stronger competitive position to win wholesale customers by the time that the relevant contracts come up for renewal.

(c) **H3G:** As explained in BT's initial Phase 2 submission, H3G is currently both a strong and aggressive wholesale competitor, and has been successful in bidding for important MVNO contracts that were recently tendered. This includes securing Carphone Warehouse **(CPW)** as a customer [✂]. H3G also has previous experience of full MVNO arrangements having entered one with Unify in 2011.[76] This demonstrates H3G's credibility as a provider of a full MVNO solution.

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[74] See http://www.mobilenewscwp.co.uk/2015/07/21/talktalk-claims-vodafone-cancelled-mvno-agreement-without-notice/.

[75] See http://www.digitalk.com/news/Latest_News/DIGITALK_selected_by_Vodafone_UK_to_support_its_MVNO_business/.

[76] See http://www.threemediacentre.co.uk/news/2011/pr-01-27-2011.aspx. Unify was acquired by Roamware in 2012 (see http://www.prnewswire.co.uk/news-releases/roamware-acquires-mvne-unify-targets-mvno-market-180093241.html), and Roamware subsequently partnered with Tismi for the launch of a MVNE platform on Three's network using Roamware's core network in 2013 (see http://technews.tmcnet.com/channels/enterprise-mobile-solutions/articles/328475-tismi-full-service-mvno-uk-powered-roamware-mvne.htm; http://wholesale.three.co.uk/wp-content/uploads/2013/08/Three-Wholesale-Tismi-announcement.pdf).

9.10 Furthermore, none of the MNOs will be subject to network capacity constraints for the foreseeable future which would limit their ability to compete effectively for the relevant full MVNO contracts on renewal.[77]

Each of the MNOs will be incentivised to bid strongly for the Sky and TalkTalk contracts

9.11 [✂] as the incumbent for Sky and TalkTalk, O2 will be incentivised to retain these MVNOs as customers in order to avoid a significant loss of revenue and profitability.

9.12 Each of the non-incumbent MNOs will also be incentivised to win future contracts for these MVNOs, in order to obtain the significant wholesale revenues available. The Parties expect that, given the nature of their (by then) established customer bases, both Sky and TalkTalk would offer an attractive wholesale margin. Indeed, this would make it more attractive for MNOs to bid for these MVNOs' business, than for other MVNOs without existing customer bases who offer less certain returns.

9.13 Furthermore, as full MVNOs, both Sky and TalkTalk will have an enhanced ability to switch compared to light MVNOs by removing the need to carry out a "SIM swap"[78] when changing host. This means that MNOs seeking to acquire one of the MVNOs from its incumbent, O2, may have a somewhat greater prospect of success [✂].

9.14 In this context, it would also be highly risky for the incumbent ([✂]) not to offer attractive terms in the hope that other MNOs would also not wish to do so. [✂]

9.15 [✂], it is most likely that each MVNO would be seeking 4G access upon renewal. It has been suggested in some of the third party submissions that MNOs may not wish to offer access to their 4G networks to MVNOs. This is not the case. For example, the Parties note that both O2 and H3G (as well as EE) already offer 4G access to MVNOs.[79] Indeed, most of the recent MVNO deals announced have provided for 4G access (e.g. [✂] BT, TalkTalk, Sky, Post Office, CPW). The Parties are not aware of Vodafone having reached an agreement with a MVNO to provide 4G access to date but, as noted above, understand that Vodafone has written to the CMA to confirm its commitment to providing wholesale access.

9.16 Each of the MNOs will be strongly incentivised to offer access to their 4G networks to secure these contracts on renewal.

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[77] See further paragraph 4.53 of BT's initial Phase II submission and Annex H (*Spectrum*) of the Notification.

[78] [✂] Note, whilst a full MVNO will need to integrate its core network with the network infrastructure of its new host MNO, this is a similar process whether starting as a full MVNO or switching to a new host.

[79] O2 currently provides (or has agreed to provide) 4G access to Sky, TalkTalk, Lycamobile, Tesco Mobile and GiffGaff; H3G provides (or has agreed to provide) 4G access to iD and Freedom Pop; [✂].

(a) First, this would be expected to be a key requirement for each MVNO [✂]). As such, each MNO would be aware that there would be limited prospects of securing the contract and the significant associated wholesale margins without providing 4G access.

(b) Furthermore, as noted above, as MNOs continue to invest in upgrading and rolling out their respective 4G networks they will be increasingly incentivised to transition more of their traffic onto the 4G networks (which uses spectrum in a more efficient manner).

(c) This includes transitioning traffic from MVNOs to 4G, as it would be inefficient for MNOs to maintain separate 2G/3G networks, and to maintain legacy 2G/3G platforms, just to host MVNOs. As explained at paragraph 8.20 above, [✂].

9.17 Even if it were the case that a MNO did not offer 4G access to MVNOs today, the Parties do not believe this would be the case in [✂] when the relevant contracts come up for renewal.

MVNOs will be able to achieve competitive tension for supply even if EE, hypothetically, did not bid

9.18 MVNOs seeking to procure complex full MVNO solutions do so through formal tender processes initially involving all MNOs in order to identify the most competitive potential hosts. However, it is not unusual for such MVNOs to narrow their discussions with potential hosts down to two MNOs very quickly, and in any event to do so prior to undertaking detailed commercial negotiations.

9.19 The competitiveness of the market does not therefore rely on the participation by all MNOs in every tender. As a result, even if it were assumed (which the Parties contest) that the merged entity may have an incentive to withdraw supply to Sky or TalkTalk, sufficient competition will remain in the market such that no SLC would arise from the merger.

9.20 [✂]

Full MVNOs conduct formal RFP processes to obtain bids from MVNOs

9.21 As noted above, [✂].

9.22 From a MVNO's perspective, the RFP process allows it to set out its initial requirements, the commercial terms it expects to receive, and the network architecture and other technical requirements that will be required to implement the solutions that the MVNO seeks.

9.23 In particular for MVNOs' which have more complex, bespoke, requirements (such as full MVNO or national roaming models), the tender process is an iterative one, typically involving initial high level discussions with all MNOs, followed by more detailed discussions with a small number of MNOs in relation to both commercial terms and the technical requirements of the MVNO. During this process, there will be a number of exchanges between

bidding MNOs and the MVNO, discussing in greater depth the MVNO's requirements, and potential solutions to meet these requirements.

Full MVNOs only engage in detailed negotiations with one or two potential hosts

9.24 In EE's experience, whilst all MNOs seeking a full MVNO arrangement are typically involved in the high level discussions at the outset of the RFP process, the MVNO will relatively quickly reduce this to, at most, two shortlisted bidders with which more detailed commercial discussions take place. This has been the case for [✂] and is expected to be the case for the relevant future contract renewals.

9.25 This is because the process of seeking agreement on a "heads of terms" is highly resource intensive, requiring extensive support from each bidding MNO's wholesale, finance and network teams, as well as considerable input from the MVNO's own technical and commercial teams. Particularly for MVNOs seeking a bespoke full MVNO arrangement to seek to undertake this process with all MNOs would be too time and resource intensive.

9.26 Prior to reducing to two shortlisted bidders, generally only exploratory discussions will take place between the MVNO and bidding MNOs, during which the MNOs will put forward their credentials and, at a high level, proposed technical solutions and indicative pricing. MVNOs will also be seeking MNOs to confirm they can meet a number of key elements of functionality and service (the large majority (if not all) of which EE would typically expect all MNOs to be able to meet). A full MVNO will not, however, typically be seeking to play MNOs off against each other at this stage, but rather to identify the MNOs which they propose to take forward for detailed negotiations.

9.27 Even after two shortlisted bidders have been identified, the MVNO may maintain a parallel process for only a very short period before selecting its preferred host, focusing on key commercial terms and technical requirements. It is at this stage that the keen bid-specific competition between MNOs can be said to take place.

9.28 It is highly likely that the MVNO will only seek to negotiate the full detail of the agreement once it has identified its preferred host and, for example, entered a heads of terms and agreed a period of exclusivity.

9.29 This is consistent with the Parties' most recent experience of tenders conducted by MVNOs seeking full MVNO arrangements:

(a) [✂]

(b) [✂]

(c) [✂]

(d) [✂]

MNOs have limited transparency of competing bids

9.30 Throughout the process, competing wholesale suppliers have no insight into the other competitors bidding for the contract, or the terms on which they are bidding, beyond any disclosure that the procuring MVNO decides to make in order to build competitive tension.

9.31 In fact, it is not unusual for each MNO to be informed by the MVNO of the best terms which are supposedly being offered by its competitors, and for it be given the opportunity to improve its own offer to match or better these competing bids. This means that MVNOs are well placed to build competitive tension between competing MNOs.

9.32 In EE's experience, [✂].

The withdrawal of the merged entity would not prevent Sky or TalkTalk from conducting a competitive process

9.33 Sky and TalkTalk are both large, sophisticated, communications providers which are well placed to use the tender processes outlined above to ensure competitive rivalry, prices and service levels. As noted above, both these MVNOs are expected to have established mobile customer bases by the time of contract renewal, and they will therefore be able to exert significant countervailing buyer power in any future bidding process. [✂]

9.34 In particular, any MVNO for whose contract the merged entity did not bid would continue to have three potential MNO hosts which, as set out above, would be strongly incentivised to win its wholesale business. There would therefore be no material effect compared to the counterfactual, in which these full MVNOs only seek to engage in detailed discussions with two MVNOs in any case. The MVNOs' ability to build competitive tension would, furthermore, ensure that it could obtain equally as attractive wholesale rates.

9.35 As noted in BT's initial Phase 2 submission, the merger must be assessed against a counterfactual in which EE does not bid for each and every MVNO contract that is put out for tender. EE's decision not to bid for MVNO contracts in the past has not prevented MVNOs [✂] from securing competitive wholesale mobile arrangements. This demonstrates that MVNOs' ability to secure competitive wholesale access is not dependent upon the participation of EE in their tender processes.

9.36 Indeed, the fact that [✂].

No adverse effect on Sky or TalkTalk as a result of a hypothetical foreclosure strategy

9.37 Given these circumstances, the hypothetical loss of the merged entity from any future tender processes by Sky or TalkTalk (or its less competitive

participation) would have no material adverse effect on the ability of MVNOs to secure competitive wholesale terms by conducting a competitive tender process amongst the other MNOs.[80] There would, therefore, be no merger specific effect on the ability of those MVNOs to compete in the retail mobile market, or to provide competitive fixed-mobile bundles.

9.38 It should, furthermore, be noted that the market for wholesale MVNO services is continuously changing as respective MNOs variously upgrade their networks and/or develop new wholesale service offerings. The competitive landscape is anything but settled, meaning that any theory of harm predicated on EE being viewed as a particularly strong competitor for MVNOs would be highly speculative given that these MVNOs' existing agreements will not come up for renewal for a number of years.

9.39 For example, [✂] As set out above and in BT's initial Phase 2 submission, both Vodafone and H3G have also been investing in improving their networks / wholesale offerings.

No material change in the merged entity's incentives to host suppliers of fixed-mobile services

9.40 There will continue to be a number of potential providers of MVNO services and the Transaction has no impact on the number of MNOs. Accordingly, the Parties do not consider that the merged entity will have any ability to foreclose MVNOs through its future bidding behaviour, and the merged entity will thus have every incentive to compete for this business since those MVNOs' competitiveness will be unaffected by whatever the merged entity does. Today, EE offers competitive MVNO services to win the wholesale margin, in the knowledge that if it did not do so, another equally capable MNO would offer the services and EE would simply lose the wholesale margin for no benefit in the retail market. Following the Transaction, the same incentive applies.

9.41 Even if it were assumed, which the Parties contest, that the merged entity would have an ability to materially restrict or degrade the services offered to other MVNOs, there is no increased incentive for it to act in such a way. The only potential material difference in the merged entity's incentives to provide MVNO services, compared to EE's incentives absent the merger, is due to BT's provision of retail and wholesale fixed telecommunications services. The same incentives still apply even taking into account fixed communications services, because retail fixed communications services are fully replicable by retailers on the basis of equal access to wholesale fixed services. As such, the merged entity will have the incentive to offer competitive MVNO services to win the wholesale MVNO margin just the same, in the knowledge that if it did not do so, another equally capable MNO would offer the services and EE

[80] See the CMA's final report dated 27 March 2014 on the acquisition of Creative Broadcast Services Holdings (2) Limited by Telefonaktiebolaget LM Ericsson, which can be found at https://assets.digital.cabinet-office.gov.uk/media/5342bd11ed915d630e00002f/Final_report__PDF__601_Kb_.pdf .

would simply lose the wholesale margin and achieve no overriding benefit either in the retail mobile market or in the retail fixed markets.

9.42 However, there could only be a change in the merged entity's incentives to deal with other MVNOs if those MVNOs also offer fixed services and a significant proportion of the MVNOs' fixed (as well as mobile) customers would switch retail fixed services provider to the merged entity because of an increased cost or reduction in quality of the MVNOs' mobile service. This is highly unlikely because:

(a) As explained in BT's Initial Submission,[81] the response of consumers and businesses to fixed-mobile propositions has been modest, with the majority of end users preferring to take standalone services. The relevant MVNO would therefore remain a strong supplier of fixed services on a standalone basis and so would be capable of retaining sales of fixed services given consumers' willingness to purchase fixed and mobile services separately.

(b) As explained above in relation to Virgin Media (see paragraph 8.18(c)), the most likely outcome of any hypothetical degradation in quality or increase in cost of a MVNO's mobile services sufficient to result in switching would be for affected consumers which have purchased both fixed and mobile services from the MVNO to terminate their mobile contract and simply to purchase their mobile service from an alternative supplier while continuing to take their fixed services from their existing supplier.

(c) Even if any fixed customers were to switch away from the MVNO and had an appetite to purchase a fixed-mobile bundle from another supplier, it is highly uncertain what proportion the merged entity would recapture because the demand for such bundles is nascent and other MNOs, including notably Vodafone, are or would seek to develop their fixed propositions to share in any recapture especially in circumstances where demand for fixed-mobile bundles was strong.

(d) In addition, given that Sky and TalkTalk do not have their own fixed local access network and instead rely on Openreach's regulated LLU (MPF) services, the merged entity's wholesale fixed services, the merged entity will already make a wholesale fixed margin in relation to those MVNOs' fixed customers. If some of Sky's or TalkTalk's fixed customers were to switch to Virgin Media (as opposed to the merged entity or another CP using BT's network), the merged entity would therefore stand to lose these wholesale fixed margins, reducing the incremental profit available.

(e) [✂]

9.43 The merger would not give rise to a material change in incentives to foreclose. This is because a hypothetical degradation in service for Sky or TalkTalk

[81] Section B of BT's Initial Submission, paragraphs 3.11-3.13.

would not result in a sufficient number of those MVNOs' fixed customers switching to the merged entity. [✂]

Alternative counterfactual

9.44 For the reasons set out in BT's Initial Submission,[82] it has to be assumed that in the alternative counterfactual (i) either the H3G/O2 merger will be blocked and the competitive conditions would therefore remain unchanged; or (ii) that transaction will be cleared on conditions ensuring continued effective competition in relation to wholesale (as well as retail) mobile services. On this basis, no incremental concerns can arise from consideration of the alternative counterfactual.

9.45 In any event, irrespective of the conditions imposed on the H3G/O2 merger, for the reasons set out in Part 9 above, MVNOs would continue to have the ability to conduct competitive tender processes in a market with three MNO wholesale suppliers to secure competitive MVNO contracts.

9.46 Any MVNO for whose contract the merged entity did not bid would continue to have two potential MNO hosts (i.e. Vodafone and a merged H3G/O2 entity) capable of meeting its wholesale requirements and strongly incentivised to win its wholesale business. Those MNOs would also have no certainty as to whether the merged entity would bid for particular MVNO contracts. It would therefore be logical for them to assume that (as the merged entity would have the capability and incentive to bid) the merged entity represented a competitive threat, even if it did not in fact bid.

9.47 As a result, the merged entity would have no ability to restrict or degrade services through its failure to bid (or to bid as competitively) for those MVNOs future contracts. For the reasons set out above, the merged entity would also not have incentives to restrict or degrade the services provided to suppliers of fixed-mobile services in the alternative counterfactual.

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82 Section B of BT's Initial Submission, paragraph 3.7.

Section D - Backhaul

10. Introduction and summary

10.1 The Issues Statement states that the CMA will investigate whether the Transaction would lead to an SLC due to input foreclosure or customer foreclosure in relation to mobile backhaul.[83] The Parties have already provided a significant amount of information making clear that BT would have neither the ability nor the incentive to engage in an input foreclosure strategy, nor would any such strategy result in reduced competition in the retail mobile market.[84]

10.2 First, there is no horizontal overlap in relation to backhaul, as EE is not active at the wholesale level.

10.3 Second, there is also no possibility of an SLC resulting from vertical effects relating to input foreclosure. BT considers that the theory of harm could not arise at all in relation to Openreach, given its regulatory constraints. Moreover, BT Wholesale has no ability to foreclose because: (i) it faces other competitive constraints from third party and self-supply alternatives to its services; (ii) regulation of Openreach imposes additional constraints ensuring that all the services it offers are readily replicable; and (iii) MNOs are protected by their existing contracts. Faced with the prospect of losing customers to other backhaul providers and MNOs' ability to self-supply, BT Wholesale has no incentive to put prices up or degrade quality for its customers.

10.4 Finally, it is not possible for an SLC to result from customer foreclosure. The merged [✂]. In any event, MBNL is not a necessary trading partner for any third party CP. The number of other possible customers and ready scope for supply side substitution means that the inability to serve MBNL would not foreclose a supplier from the leased lines market.

10.5 The remainder of this section engages directly with the Issues Statement and is therefore structured as follows:

(a) Part 11 deals with market definition;

(b) Part 12 deals with theory of harm 4; and

(c) Part 13 deals with theory of harm 5.

11. Market definition

11.1 As recognised by the Issues Statement,[85] market definition is merely an analytical tool to assist in the CMA's review. Constraints can also be taken into account during the competitive effects analysis. Even if the CMA does

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83 Issues Statement, paragraph 59 onwards.

84 See Section C of BT's Initial Submission, Annex E of the Merger Notice and BT's responses to MQ1.

85 Issues Statement, paragraph 12.

not conclude that particular alternatives constitute a sufficiently close substitute to form part of the same 'market', it is important to take them into account as part of the range of alternatives available to MNOs for backhaul, which together act to preclude any ability or incentive for BT to foreclose. On that basis, it is not necessary for the CMA to reach a firm conclusion on market definition, as there will be no SLC regardless of the specific market definition chosen.

11.2 First, BT considers that there is a broad market for leased lines.[86]

(a) Ofcom has concluded, both in its 2013 BCMR Statement and again in its current BCMR consultation, that there is no separate 'mobile backhaul' market.[87]

(b) Mobile backhaul and other leased lines are technically equivalent, such that another supplier of leased lines could easily switch to supplying mobile backhaul.[88]

(c) There is also significant demand substitution. MNOs already use a range of options for mobile backhaul, including wholesale Ethernet services which are also used by enterprises and fixed line CPs.[89]

11.3 Second, both fixed and microwave backhaul are used by all of the MNOs.[90]

11.4 The MNOs have historically taken different strategic decisions about microwave use, with Vodafone and O2 choosing to deploy less microwave than H3G and EE (through MBNL). However, the fact that MBNL deploys microwave across approximately [✂] of its estate shows that it can be an effective alternative, particularly in order to expand the reach of other alternative backhaul options.[91] Indeed, [✂].

11.5 [✂] capacity, planning issues, weather conditions and/or availability of unlicensed microwave spectrum raise no significant issues that prevent microwave from being a viable option across a large proportion of cell sites, at least in the 'access' (as opposed to 'aggregation') network layer, in order to reduce reliance on fixed lines.[92] Microwave capacity approaching 1Gbps is

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86 In relation to the Issues Statement, paragraph 27(a).

87 Section C of BT's Initial Submission, paragraphs 2.2 and 2.3 and Annex E of the Merger Notice, paragraphs 4.6 - 4.9.

88 See BCMR consultation, May 2015, paragraph A.11.71.

89 [✂]

90 See Issues Statement paragraph 27(b). Note that, although MNOs are currently making less use of copper-based backhaul, it is possible that G.Fast technology could improve data rates over copper in certain scenarios.

91 See Section C of BT's Initial Submission, paragraphs 4.26 - 4.30.

92 See http://www.ericsson.com/res/docs/2014/microwave-towards-2020.pdf for details on microwave capability and its expected continued role in backhaul going forwards: "Today, microwave transmission dominates mobile backhaul, where it connects some 60 percent of all

possible today. Moreover, technological developments (including E-band and XPIC[93]) are further increasing the capacity of microwave links and therefore its suitability for microwave backhaul.[94]

11.6 Microwave is typically not used at the aggregation level. However, it is widely used at the access level – in substitution for fibre – by MBNL, Vodafone and O2. Although not a complete substitute for fibre, therefore, microwave's suitability for use at the access layer provides MNOs with an important alternative to relying on end-to-end (i.e. cell site to mobile core) managed or unmanaged fibre networks. In particular, when microwave is used alone or in combination with non-BT sources of both active and dark fibre to link (i) cell sites to each other on a parent-child/daisy chain basis and/or (ii) cell sites to an aggregation network, microwave enables MNOs to reduce their reliance on Openreach and BT Wholesale fibre products over a very wide part of the UK. This in turn facilitates MNOs' use of non-BT sources of backhaul at the aggregation level, even if the non-BT provider's aggregation network is not geographically as extensive as BT Wholesale's 21CN: see paragraph 11.8 below.

11.7 Third, the CMA wishes to consider whether "the supply of mobile backhaul using managed, unmanaged and dark fibre networks should be considered as separate markets".[95] Managed backhaul services make use of unmanaged inputs (such as Openreach's or Virgin Media's access networks, or third party dark fibre networks).[96] However, the extent of management offered varies by product and using unmanaged inputs is an effective alternative option for mobile operators.

11.8 From a demand perspective, there is clear evidence of substitution between managed and unmanaged solutions. There is no economic or technical reason why unmanaged solutions could not be used to replace fully managed solutions either entirely, or to a more significant extent, going forwards.

(a) [✂]

(b) [✂][97]

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macro base stations. Even as the total number of connections grows, microwave's share of the market will remain fairly constant. By 2019, it will still account for around 50 percent of all base stations (macro and outdoor small cells (see Figure 3). It will play a key role in last mile access and a complementary role the aggregation part of the network."

93 Cross polarization interference cancellation technology.

94 Higher data rates are on equipment vendor road-maps. Millimetre wave radio systems operating at 60, 70 and 80GHz can support significantly higher data rates, up to 2Gbps today (with 10Gbps on road-maps) and are suitable for shorter-links in urban areas.

95 Issues Statement, paragraph 27(c).

96 Annex E of the Merger Notice, paragraphs 3.4 - 3.10 and 4.10.

97 See BT's Initial Submission, paragraph 4.12 for details of the extent of the management layer for EACs and the responses to the BT1 RFI relating to Wholesale Ethernet and MMWE. See also the

(c) [✂]

(d) Virgin Media's mobile backhaul solution also involves a 'lighter' management layer as it requires self-provision of CSGs by MNOs. BT understands that all of the MNOs acquire some circuits from Virgin Media.

(e) [✂] MBNL has also made some purchases of dark fibre from CityFibre in Hull. [✂][98]

(f) It is clear from the MNOs' responses to Ofcom's BCMR consultations that they consider that if Openreach were to provide dark fibre, such access could be used to construct alternative backhaul solutions to BT Wholesale's managed MEAS service (although BT does not agree that it is necessary to mandate access to BT's dark fibre given the level of competition based on active regulation which is already in the market).

11.9 From a supply perspective, the 'management layer' is easily replicable, either by MNOs themselves or by third parties. A fully managed service constitutes the access layer (such as Openreach EADs), plus aggregation (such as provided through BT's 21CN) and a 'management wrap'. Various other providers already offer aggregation services based on their own networks (such as TalkTalk, Virgin Media and Vodafone). BT's 21CN network (used by BT Wholesale in Wholesale Ethernet and in MEAS, as well as other services not used for mobile backhaul such as Wholesale Broadband Connect) does not have any particular advantages over these alternatives as they are all scale networks. The additional management services provided on top of aggregation are a small part of the cost structure, and can also easily be provided either by the MNOs themselves, as they already do across part of their requirements (as noted in paragraph 11.8 above) or third parties (such as Ericsson or NSN). These services involve provisioning and managing the CSG (which can be bought off-the-shelf) [99], and providing an end-to-end customer service.

11.10 Finally, the CMA intends to investigate whether "competition for the supply of mobile backhaul is subject to regional differences within the UK".[100] BT considers that a national geographic framework is appropriate in this case.[101]

(a) All providers are able to use the unmanaged inputs from Openreach (EAD) on a national basis on equal terms, such that downstream services are fully replicable and fully competitive on a national basis.

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backhaul slides from the site visit for descriptions of Openreach's and BT Wholesale's backhaul products.

98 EE confidential response to CMA information request EE2 of 21 July 2015.

99 [✂]

100 Issues Statement, paragraph 27(d).

101 See Annex E of the Merger Notice, paragraph 5 and Section C of BT's Initial Submission, paragraph 3.2.

(b) BT has some differentiated pricing for Local Access and non-Local Access circuits, which depends on the distance from the exchange. However, these two levels of pricing apply nationally: there is no regional pricing. Contracts tend to be for a volume of circuits, without commitments to any particular locations at the time of contracting.

(c) Although some competitors do not have the same reach as BT Wholesale, they could use Openreach access inputs to expand their reach (purchasing such inputs on the same basis as BT Wholesale)[102] and so could compete nationally if they chose to do so.[103] For instance, Virgin Media (which is significantly investing in expanding its network currently) could also offer backhaul services outside its footprint by combining with Openreach inputs.[104]

(d) Although there are some regional differences at the access layer (e.g. Hull, where BT is not present, or the London area as defined by Ofcom, where there is a substantial number of providers), these differences would not apply if the CMA considered 'managed backhaul' as the frame of reference, given that it is an end to end service which does not require a national, physical network.

(e) MNO customers typically tender for backhaul services on a national basis, not providing the possibility of regional pricing.

12. Theory of harm 4: Mobile backhaul - input foreclosure

12.1 BT welcomes the Issues Statement's apparent acceptance that a theory of harm based on total input foreclosure is implausible. BT considers that partial foreclosure is similarly implausible as an attempt to raise prices or reduce quality would in fact cause customers to switch their requirements entirely or substantially to one or more alternative providers: the merged entity will have neither the ability nor incentive to engage in partial input foreclosure in the supply of its mobile backhaul products.[105]

12.2 The Issues Statement indicates that questions about partial foreclosure are "more likely to arise in relation to the supply by BT Wholesale of managed mobile backhaul services and in particular, the supply of MEAS and, to a lesser extent, the supply by Openreach of unmanaged mobile backhaul services."[106] BT notes that the Phase 1 Decision asserts that partial foreclosure

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[102] This has been publicly acknowledged as an option by Vodafone, which stated in its Analyst and Investor Conference Call in February 2015 that it would launch its broadband (which will use the same network as Vodafone's backhaul self-supply) "*with a combination of access to the Openreach fibre and our own 60%, around, coverage through the Cable & Wireless old exchanges, and we will follow the development of Openreach. So, from that point of view, we'll not have a gap or a disadvantage versus the BT footprint*."

[103] Section C of BT's Initial Submission, paragraph 4.21.

[104] Annex E of the Merger Notice, paragraph 7.23.

[105] In relation to the Issues Statement, paragraph 59.

[106] Issues Statement, paragraph 60.

could occur by price increases or quality degradation either at the end of the MNOs' contracts or within the life of the contracts.

12.3 As a preliminary matter, BT considers that the theory of harm could not arise at all in relation to Openreach, given its regulatory constraints. Openreach could not increase prices nor degrade quality in a discriminatory manner due to its equal access or Equivalence of Inputs (**EOI**) obligations under the Undertakings and the SMP regulation imposed on it by Ofcom.[107]

12.4 Moreover, BT Wholesale has no ability partially to foreclose because: (i) it faces competitive constraints from third party alternatives to its services; (ii) regulation of Openreach inputs imposes additional constraints ensuring that all of its services are readily replicable; and (iii) MNOs are protected by their existing contracts.

(a) BT has set out in detail the alternatives to its own services.[108] These alternative providers are either already in use by MNOs, or are already in the business of wholesale leased lines and could easily expand their business to offer services to MNOs.

(i) All of the MNOs currently multi-source their requirements, and they could reduce their reliance on BT Wholesale to make more use of both existing and prospective alternative providers.

(ii) Switching costs are not sufficiently large to prevent MNOs from switching providers. This is clear from the fact that MNOs do, in fact, switch between providers.[109] Given that contracts tend to be long-term to provide the MNO with certainty of supply, any cost involved in running parallel circuits for a short period of no more than 6-9 weeks would not be material as against the gain from achieving an improved total cost of ownership (***TCO***) over the life of the contract.

(b) In addition, regulated Openreach products impose a resulting constraint on BT Wholesale, as recognised by Ofcom,[110] which also precludes any possibility of foreclosure by BT Wholesale. A significant proportion of BT Wholesale's costs are regulated inputs from

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[107] BT has provided details of regulation and its effects in Annex E of the Merger Notice, paragraphs 7.3 - 7.14 and Section C of BT's Initial Submission, paragraphs 4.2 - 4.6.

[108] Initial Submission C4.11-4.31 and MQ1.

[109] For example, MBNL has switched part of its requirements from BT Wholesale to Virgin Media.

[110] See the BCMR Statement 2013, paragraph 7.157: "*In the presence of upstream regulated Ethernet services, there should not be barriers to [other communications providers] replicating a MEAS solution. Therefore, we would expect BT Wholesale to be constrained in its pricing of these downstream services, either due to threat of competition or rivals entering to provide similar managed services.*"

Openreach, so BT Wholesale does not control price or quality for those inputs.[111]

(c) BT Wholesale is also subject to contractual commitments which govern its service provision as well as pricing, thereby providing protection to the MNOs.[112] BT Wholesale could not deteriorate the quality of service which it provides without being subject to significant financial penalties, which must be taken into account in considering any purported financial gains at the retail level from foreclosing rivals. There will not be any changes to these contracts as a result of the Transaction so there can be no merger effect on BT Wholesale's ability resulting from the Transaction. Moreover, cost increases or quality degradation at the end of the contract would not be effective: the backhaul contracts are long-term and provide the MNOs with sufficient time to switch to alternatives. Negotiations for a new contract begin significantly in advance of the end of the contract [✂]. Nor does BT Wholesale expect that any significant renegotiation would be necessary within the time it would take MNOs to develop new alternative sources of supply if necessary.

12.5 BT has no incentive partially to foreclose competing MNOs at the wholesale level as it would not recoup enough revenues at the retail level to make up for lost wholesale revenues.[113] BT does not have any incentive to raise prices or degrade quality of service because each of the MNOs has alternatives to BT Wholesale supplied backhaul so could switch supplier to avoid BT's foreclosure strategy. In addition to the third party alternatives mentioned above, it should be noted that:

(i) Vodafone is on the path to self-supply and can soon choose not to make any purchases from BT Wholesale if the terms of supply are not favourable to Vodafone;

(ii) O2's relationship with Vodafone through the CTIL network sharing agreement affords O2 similar protection because:

(A) O2 benefits from Vodafone's self-supply in the part of the country where Vodafone is responsible for the CTIL backhaul; and

(B) Vodafone could provide backhaul to O2 (copying its own self supply arrangements) for the part of the country where O2 is responsible for CTIL backhaul. [✂][114];

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[111] See Section C of BT's Initial Submission, paragraphs 4.7 - 4.10.

[112] See Annex E of the Merger Notice, paragraphs 7.52 - 7.58, Section C of BT's Initial Submission, paragraphs 4.32 - 4.36 and BT's response to MQ1.

[113] See Section C of BT's Initial Submission, paragraphs 4.39-4.46.

[114] EE confidential response to CMA information request EE2 of 21 July 2015.

(i) H3G is protected by the rules of the MBNL network sharing agreement [✂].

12.6 Because of the availability of suitable alternatives, BT Wholesale would not have the incentive to raise price or degrade quality, either at the end of the MNOs' contracts or within the life of the contracts.

(a) In relation to quality degradation at the end of the current contracts, the only way this could occur would be to offer lower capacity or less attractive terms than desired by the MNO. The result of this would in effect be equivalent to a price rise. In either case MNOs could switch to an alternative provider, given that there are other existing and prospective options available.

(b) Turning instead to the period before the end of the contract, BT Wholesale does not have any incentive to increase costs or degrade quality.

(i) This concern can only be relevant in the period before MNOs could switch to alternative suppliers (which BT estimates is no more than approximately 18 months[115]). During this period customers are contractually protected in relation to price, therefore BT Wholesale has no ability to increase price and incentives do not arise. During this period customers are also contractually protected in relation to quality. Any degradation of quality within the period of the contract would involve a breach of BT Wholesale's contractual obligations and would mean that BT Wholesale would incur financial penalties in favour of the MNO.

(ii) For the reasons set out in paragraph 12.5 above, BT Wholesale is incentivised to retain the MNO's custom at the end of the contract, rather than lose the business to alternative suppliers. It does not therefore have any incentive to upset its customers by trying to raise prices within the life of the contract.

(iii) Even if BT Wholesale could impose some cost increase before customers could switch, the pass through into final retail prices is likely to be limited (as set out in 12.7 below).

(iv) In respect of putative quality degradations, even if BT Wholesale could degrade quality, at its worst this could only amount to delays in provisioning new circuits or in maintenance.

(A) MNOs plan their requirements with plenty of lead time to ensure that any upgrades or new circuits are in place well before capacity constraints are reached. Therefore any concerted strategy of delaying provision of circuits (which could only be by BT Wholesale delaying

[115] See BT's response to MQ1 Question 16.

requests to Openreach, as Openreach provision times are regulated) for instance, by 10%, would not lead to an effect on customer experience, and BT Wholesale could not expect any recapture of retail revenues.

(B) Any degradation through delays to repairs or maintenance could only apply in relation to the aggregation network (as the access layer is the responsibility of Openreach, rather than BT Wholesale and is heavily regulated, including on an EOI basis) or to the CSG. It would not be logical to delay maintenance to the 21CN network as it would affect all of BT Wholesale's customers including its own downstream operations, fixed line CPs, enterprises etc, (and BT Global Services customers) as 21CN is a shared network; it is not possible to target any degradation at a particular category of customer. Even if BT did attempt such a strategy, the nature of an aggregation network is to provide resilience and fallback, limiting the effect of any disruption. A failure to repair faults in the CSG could be resolved very easily by the MNO itself, either directly using its own field force, or by employing a third party, which would not involve much cost. Therefore, there would not ultimately be any effect on customer experience, and no expectation of recapture of retail revenues.

12.7 As already explained, even if BT Wholesale did have both the ability and incentive to try to follow a foreclosure strategy, there would not be any effect on consumers.

(a) Any theoretical increase in price (which would not be possible without losing business and profits, as explained above) would not affect the MNOs' retail offering as backhaul costs are generally small and fixed as a proportion of overall costs, as accepted in the Phase 1 Decision.[116] Therefore, even if BT attempted a foreclosure strategy based on price, it would not have an effect on consumers.

(b) Any attempted degradation in quality by BT Wholesale would also not be likely to affect consumers, as it could be resolved by the MNO well before it affected its retail offering. Even if the MNO needed to incur some extra cost in order to resolve any quality issues, as in (a) above, this would also be small as a proportion of overall costs and so not be likely to be passed through to consumers.

12.8 Finally, the Issues Statement also notes that the CMA will consider the extent to which MNOs depend on BT for innovation in backhaul and whether this

[116] The Decision, paragraph 113.

would be affected by access to dark fibre.[117] It is not the case that MNOs are dependent on either Openreach or BT Wholesale for innovation.

(a) To the extent that the MNOs would like particular developments from Openreach, the Statement of Requirements (***SOR***) process is run on an EOI basis under the oversight of the Equality of Access Board, and disputes can be taken directly to Ofcom.[118] In fact, it is clear that the MNOs do not depend on Openreach in any case. For example, the development of synchronisation solutions was not led by Openreach, but by backhaul providers who developed their own methods for synchronisation instead: Virgin Media developed its own version, and BT Wholesale made use of IEEE1588v2.

(b) There is nothing particularly innovative in the 'management layer' of services offered by BT Wholesale. The CSG itself is off-the-shelf equipment from third parties, while the 'management wrap' of customer and network management are services of convenience for MNOs, but do not affect the quality of the backhaul or of their ultimate retail offers.

(c) Dark fibre (both existing third party options and if mandated by Ofcom) would add to the options available to MNOs, but it does not affect the analysis of the Transaction, given that there are already numerous options available.

12.9 Even if the MNOs did rely on BT for innovations, BT is not aware of any identifiable technical innovations which would be more favourable to rival MNOs than to EE, and so it would not be in BT's interests to delay or block their development.[119] Moreover, the geographic areas where possible technical innovations in mobile networks (such as C-RAN) are most likely to be required and implemented are those in which there is a high level of consumer demand. These are precisely the geographic areas in which there is the greatest amount of alternative fibre infrastructure, and where higher-capacity microwave backhaul is more suitable. If, hypothetically, BT were not to develop a particular technical solution, this would incentivise MNOs to shift their demand to BT's rivals, which would obviously not be in BT's interests.

13. Theory of harm 5 - Mobile backhaul - customer foreclosure

13.1 It is not the case that, as a result of the Transaction, the merged entity would have the ability and incentive to engage in customer foreclosure of other backhaul suppliers.[120]

13.2 [✂]

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[117] Issues Statement, paragraph 62(a).

[118] See BT's responses to MQ1.

[119] See BT's responses to MQ1.

[120] In relation to Issues Statement, of BT's Initial Submission,63.

(a) EE is part of the MBNL network sharing joint venture with H3G. [✂].[121]

(b) This is clearly evidenced by the fact that [✂].[122]

13.3 [✂], this would not have the effect of foreclosing other actual or potential suppliers.

(a) MBNL is not a necessary trading partner.[123] For instance, an analysis of other backhaul providers shows the following:

(i) *Zayo*: Out of 12 instances of Zayo rolling out its dark fibre network in the UK, only 2 relied on demand from MNOs. [124]

(ii) *CityFibre*: Out of 7 instances of CityFibre rolling out its dark fibre network in the UK, only 1 involved partnering with an MNO.[125]

(b) There is significant supply side substitution between 'mobile' backhaul and other leased lines. Even if a supplier failed to win a contract with EE following the Transaction, it would still have the technological capability to supply MNOs. For instance, Virgin Media supplies wholesale Ethernet to enterprises, fixed line operators and other CPs. Even if it ceased to supply MBNL, this would not have any effect on its enterprise business and so it could increase its supply to MNOs again at any point in the future. This is equally true for Vodafone Carrier Services and TalkTalk among others.

(c) There are a significant number of potential suppliers in relation to dark fibre. [✂][126] None of these providers are dependent on MBNL or EE for the launch of services and supply a range of other wholesale and retail customers.

(d) Numerous competitors in FTTC and FTTH have successfully launched without any sales to MBNL or EE.[127] Access to MBNL or EE is not necessary to compete in the supply of wholesale local access.

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121 See Annex E of the Merger Notice for details of MBNL's arrangements.

122 [✂]

123 See Annex E of the Merger Notice, paragraphs 8.4 - 8.6.

124 Zayo press releases.

125 CityFibre admission document, Annual Report 2014 and press releases.

126 EE confidential response to CMA information request EE2 of 21 July 2015.

127 See BT's response to Ofcom's VULA Margin consultation for details of competitors, paragraphs 4.57 and 4.58, http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/responses/BT_Group.pdf

Section E - Wholesale Broadband

14. Introduction and summary

14.1 The Issues Statement identifies a theory of harm relating to the Transaction's impact on BT's ability and incentive to increase the price or reduce the quality of wholesale inputs that rival CPs need to provide retail broadband services.[128]

14.2 The Transaction will not provide BT with the ability to engage in complete or partial input foreclosure:

(a) BT's wholesale broadband business is tightly regulated such that BT currently has no wholesale ability to foreclose rival retail broadband providers. As an SMP operator at the wholesale level, BT is under constant scrutiny from Ofcom, as part of regular market reviews, in considering actual or potential complaints or disputes brought by third parties, and through regular information gathering activities. In addition to the Ofcom SMP regulations, BT is subject to a further regulatory layer governing Openreach which inherently removes BT's ability to discriminate among downstream CPs. For those wholesale broadband services that are subject to regulation, the level of regulation has been carefully designed on a forward-looking basis to ensure that the interests of competitors and consumers are protected. Wholesale broadband services that are not subject to regulation have by definition been found by Ofcom to be constrained by effective competition.

(b) BT is also subject to competition laws generally, including the Competition Act 1998 and analogous EU prohibitions on margin squeeze.

(c) The Transaction will not diminish the effectiveness of these regulations, nor the state of competition in those areas where regulation has been relaxed or judged unnecessary. The merged entity will therefore have no post-Transaction ability to foreclose rival retail broadband providers. It is not therefore necessary for the CMA to consider the Transaction's impact on BT's incentives in the supply of wholesale broadband services.

(d) Even if the CMA does wish to consider whether the Transaction changes BT's wholesale incentives, it is not obvious that there is any such change. The regulatory regime governing BT's supply of wholesale broadband services is predicated on an Ofcom view that BT already has a pre-Transaction wholesale incentive to favour BT's downstream retail business over rival retail suppliers. Any assessment of the Transaction's effect on BT's incentives in relation to the supply of wholesale broadband services would need to take account of the fact that BT's recent entry as an MVNO (and therefore as a fixed-mobile provider in competition with Virgin Media, TalkTalk, Sky and other CPs) would arguably have given BT the same wholesale fixed

[128] Issues Statement, paragraph 67.

broadband incentives in the counterfactual as it will have after the Transaction. That said, the point made in sub-paragraph (c) above obviates the need for the CMA to reach a view on the Transaction's effect on BT's incentives.

14.3 As a result, it is not credible to suggest that BT as a provider of wholesale inputs could engage in complete or partial input foreclosure of its downstream rivals as a result of the Transaction.

14.4 The remainder of this section engages directly with the Issues Statement and is therefore structured as follows:

(a) Part 15 deals with market definition; and

(b) Part 16 deals with theory of harm 6.

15. Market definition

Wholesale broadband inputs should be considered within the same wholesale market

15.1 The Issues Statement notes that the CMA "may consider the extent to which the different wholesale broadband inputs (WBA, VULA and LLU) should be considered as separate markets."[129]

15.2 WBA, VULA and LLU serve the same purpose in facilitating entry into the retail broadband market. Specifically, WBA products offer the opportunity to enter the retail market without the need to deploy an access network. LLU and VULA are remedies relating, respectively, to Openreach's Metallic Path Facility (***MPF***) and Shared Metallic Path Facility (***SMPF***) (for copper lines) and Generic Ethernet Access (***GEA***) (for fibre lines) products, and likewise provide downstream retailers with the means to serve retail broadband customers.

15.3 Given their shared purpose in facilitating entry into the retail market, WBA, VULA and LLU should not be considered as separate product markets.

15.4 Ofcom has established that demand for WBA is derived from demand for retail broadband services,[130] and that supply by LLU and VULA therefore constrains BT's WBA pricing.[131] Ofcom has found specifically that cable and

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[129] Issues Statement, paragraph 29.

[130] Ofcom, *Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies* (26 June 2014) (***2014 WBA Market Review)*** at paragraph 3.206.

[131] Ofcom, *2014 WBA Market Review*, paragraph 3.204. The Issues Statement notes on this issue at paragraph 76(b) that the CMA may consider how products provided over WBA differ from those offered over LLU. BT notes that from a consumer perspective, broadband products provided over WBA do not differ from those provided from unbundled exchanges. In addition to concluding that supply by LLU and VULA constrain BT's WBA products, Ofcom and the Competition Commission have considered and rejected suggestions that LLU-based competition is somehow superior to WBA-based competition (see e.g. paragraphs 7.76-7.80, 7.122 and 7.145 of the March

LLU-based rivals contribute to effective retail competition, and where this is the case retailers using WBA are unlikely to be able to absorb a significant increase in wholesale costs. It is therefore likely in Ofcom's view that "a high proportion of an increase in the WBA price by a hypothetical monopolist would be passed on by retailers using WBA, and that this is likely to result in a significant loss of volume to cable and LLU rivals." BT is not aware of any current or prospective market developments that warrant deviating from this conclusion.

15.5 In any case, as set out in BT's response to the MQ, the Transaction will not give rise to any competitive concerns even under the narrowest possible wholesale market definition. It is not therefore necessary for the CMA to conclude definitively on the scope of the relevant product market.

16. Theory of harm 6: Wholesale broadband - input foreclosure

The Transaction will not provide BT with ability to foreclose (partially or completely)

The Transaction will not render the VULA margin squeeze regulation ineffective

16.1 The Issues Statement states that the CMA is likely to investigate "whether the merger will increase complexity in such a way as to make the VULA margin squeeze regulation ineffective."[132]

16.2 Ofcom's Fixed Access Market Reviews: Approach to the VULA margin statement (the ***VULA margin statement***) sets out a scheme of VULA margin regulation that inherently requires Ofcom to carry out a forensic line by line assessment of BT's costs and revenues. Ofcom has in fact signalled that it intends to take into account the provision of mobile services by BT in its approach to the application and enforcement of the VULA regulation.[133] Ofcom has signalled in the VULA margin statement that the regulation is sufficiently flexible to take the combined BT/EE into account.[134] The types of costs and revenues that Ofcom would expect to incorporate within the margin test following the Transaction are also described comprehensively in paragraphs 5.87-5.88 (*Inclusion of mobile services*) and 6.69-6.74 (*Approach*

2013 Competition Commission decision on the appeal of Ofcom's 2012 WLR and LLU charge control available at http://www.catribunal.org.uk/238-7998/Ruling-on-disposal-of-appeals.html). This supports the view that WBA and LLU are properly characterised as being within the same product market.

[132] Issues Statement, paragraph 70.

[133] Ofcom "consider[s] that mobile services would be no different to any other bundled element and hence bundles that include mobile services would be taken into account in the VULA margin assessment." (VULA margin statement, paragraph 5.87).

[134] "BT is in the process of acquiring an existing mobile operator. It is thus appropriate to provide a degree of clarity for BT and other operators on how we would likely treat mobile services." (VULA margin statement, paragraph 5.88.)

to bundled services not currently offered by BT (e.g. mobile services)).[135] It is therefore implausible that BT's acquisition of EE will present Ofcom with a degree of complexity that it did not envisage when developing the test and which could render the VULA margin squeeze regulation ineffective.

16.3 Furthermore, Ofcom can and readily does modify the VULA margin squeeze regulation and underlying assessment methodology to accommodate material changes in circumstances. Ofcom has, for example, consulted recently on how to take account the inclusion of UEFA football content in BT's BT Sport proposition in its assessment of the VULA margin condition.[136] After exercising its discretion to find that this development created a material change in circumstance, Ofcom published a consultation on supplementary guidance on the way in which it proposes to accommodate this change to the BT Sport proposition into the VULA margin assessment. Given this demonstrated flexibility, there is no reason to doubt Ofcom's ability to respond effectively and transparently to any potential material change in circumstance brought about by the Transaction. It cannot therefore credibly be said that the Transaction could render the VULA margin squeeze regulation ineffective.

16.4 Finally, BT notes that third parties have suggested that the VULA margin squeeze regulation remains "untested."[137] This is not correct. BT is currently under an obligation to comply with the VULA margin regulation and has provided reporting to Ofcom in accordance with that obligation. Ofcom has in fact applied and found that BT has passed the VULA margin squeeze test during the first assessment period,[138] as well as having passed an ex-post competition law margin squeeze test.[139] In addition, BT is subject to competition laws generally, including the Competition Act 1998 and analogous EU prohibitions on margin squeeze.

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[135] BT notes also that third parties have suggested that the VULA margin assessment could be rendered ineffective if BT Sport is bundled with mobile products. BT Sport is in fact already available to mobile customers (http://sport.bt.com/sport-football/news/free-premier-league-for-bt-mobile-customers-S11363970611764). Furthermore, as set out above, the VULA margin assessment is sufficiently flexible to accommodate other hypothetical changes to the manner in which BT Sport is offered to customers. Ofcom recognises on the issue of bundling paragraph 6.70 of the VULA margin statement, for example, that "even though the approach to services that BT subsequently introduces during the market review period would not be included in this guidance, the relevant costs and revenues would nevertheless be included in VULA margin assessments."

[136] See http://stakeholders.ofcom.org.uk/consultations/vula-margin-guidance-supplementary/.

[137] See e.g. *Sky Response to CMA Preliminary Invitation to Comment on the Anticipated Acquisition by BT Group Plc of EE*, 18 March 2015, paragraph 5.31.

[138] See http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/cases-in-compliance/bt-compliance-vula-margin-control/?utm_source=updates&utm_medium=email&utm_campaign=vula-margin-control.

[139] See http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01103/.

Existing regulation sufficiently constrains BT's ability to allocate common and fixed costs

16.5 The Issues Statement notes that the CMA is interested in "whether the merger will increase BT's flexibility to allocate fixed and common costs in such a way as to permit an increase in the prices of regulated services (such as LLU)."[140]

16.6 BT's leeway in allocating fixed and common costs, including for the purpose of the VULA margin squeeze regulation,[141] is closely constrained by rules developed by Ofcom.[142] Among other constraints, these rules include a change control process that requires BT to notify and obtain approval from Ofcom of any proposed changes to BT's regulatory accounting methodology. Ofcom reviews proposed changes over a two month period and – critically – has discretion to veto such proposals. Any attempt by BT to allocate costs improperly in such a way as to increase the prices of regulated products is therefore subject to Ofcom veto. This will not change following the Transaction. Furthermore, in setting charge controls, Ofcom reviews those costs that it considers to be relevant and excludes those costs that it concludes are not. This serves as a further constraint on BT's leeway in the cost allocation process.

16.7 The methodology governing BT's allocation of costs is set out in detail in BT's published Regulatory Financial Statements. These statements are independently audited and published on an annual basis. In order to ensure compliance with the cost allocation rules, BT is required to issue to Ofcom and publish online an annual report setting out the changes that BT proposes to make to the allocation of costs in that year's Regulatory Financial Statement. BT is also required to issue a statement quantifying the impact of such proposed methodology changes on any services and markets, based on prior year numbers. Finally, BT is required to publish with the Regulatory Financial Statement a report explaining and quantifying the impact of proposed changes on *current* year numbers.[143] The requirement to quantify the impact of proposed cost allocation changes based both on prior and current year numbers facilitates transparent comparability and therefore serves as a powerful disciplining mechanism on BT.

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[140] Issues Statement, paragraph 70.

[141] See e.g. VULA margin statement at Section 5.

[142] The rules constraining BT's leeway in allocating costs are also subject to continued refinement by Ofcom. For example, in 2014 Ofcom issued a decision setting out changes that Ofcom had decided to make to BT's regulatory financial reporting requirements. These 2014 changes are notable in that they: (a) give Ofcom an even greater role in the way that BT prepares its regulatory financial statements; and (b) enhance transparency of BT's cost allocation methodology by improving the presentation of BT's Regulatory Financial Statements and supporting documentation. See http://stakeholders.ofcom.org.uk/binaries/consultations/bt-transparency/statement/financial-reporting-statement-may14.pdf.

[143] BT's Regulatory Financial Statements and related documents are available online at http://btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm.

16.8 Following the Transaction, BT's compliance with these cost allocation rules will continue to be vigorously enforced by Ofcom, just as it is today. Ofcom has a strong track record of monitoring and intervening in BT's cost allocation methodology. This is illustrated, for example, by the *Review of BT's cost attribution methodologies* published by Ofcom in June 2015. This audit of BT's compliance with cost allocation rules identified and required the correction of inadvertent errors relating to the manner in which BT's cost allocation had been implemented.[144] The Transaction will not diminish Ofcom's ability to monitor and enforce the rules constraining BT's ability to allocate costs to the regulated parts of BT's business. BT anticipates that its allocation of costs may in fact be subject to increased scrutiny from Ofcom and industry stakeholders following the Transaction.

16.9 Finally, Ofcom has also engaged independent consultants (Cartesian) to review BT's cost allocations methodologies. The purpose of this review is to: (i) provide Ofcom with an overview of BT's cost attribution system; (ii) help Ofcom and other stakeholders to identify the cost categories and attribution rules that account for a significant proportion of the costs allocated to regulated services; (iii) explain how those costs are attributed in BT's cost attribution system; and (iv) consider whether the attribution bases are consistent with the regulatory accounting principles.[145] This demonstrates Ofcom's commitment to effective regulation of BT's wholesale activities.

16.10 In summary, BT has very little flexibility in how it allocates fixed and common costs, and its methodologies are subject to close scrutiny. Most importantly, any attempt by BT to allocate costs in such a way as to permit an increase in the prices of regulated services following the Transaction will be transparent to industry stakeholders and subject to Ofcom veto. As noted above, this extends to the allocation of fixed and common costs in the VULA margin squeeze model. It is not therefore plausible that BT could as a result of the Transaction manipulate cost allocations so as to permit an increase in the prices of regulated services.

The regulations governing BT's supply of wholesale superfast broadband (SFBB) inputs preclude input foreclosure

16.11 The VULA margin squeeze regulation is one of several regulations imposed upon BT in the wholesale local access (***WLA***) market to preclude the foreclosure of essential wholesale inputs. These regulations and their impact on competition in the WLA market are explained in detail in Ofcom's 2014 *Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30 statement*. To summarise, BT's supply of WLA over next generation technologies is subject to a number of requirements, including to:[146]

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[144] Ofcom, *Review of BT's cost attribution methodologies,* 12 June 2015).

[145] Ofcom, *Review of BT's cost attribution methodologies,* 12 June 2015 at paragraph 1.9.

[146] Ofcom, *Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30 statement* [*2014 FAMR statement*], paragraph 12.1. These requirements

(a) provide VULA[147]: (i) on fair and reasonable terms, conditions and charges; (ii) on an equivalence of inputs (***EOI***) basis; and (iii) without any undue discrimination among downstream CPs;

(b) comply with a charge control for the migration costs of VULA customers between CPs;

(c) limit the minimum contract period following a VULA migration to one month; and

(d) comply with the quality of service obligations set out in section 9 of the 2014 FAMR statement, which include meeting defined fault repair and provisioning standards, increased reporting of key performance indicators and including SLAs and SLGs in reference offers for select services (including GEA).

16.12 Collectively, these regulations prevent BT from the partial or complete foreclosure of access to essential wholesale SFBB inputs. There is no basis to doubt that these regulations will remain effective following the Transaction. As a result the Transaction does not create any risk of input foreclosure in respect of SFBB inputs.

16.13 In any event, the VULA margin regulation ensures that BT maintains a sufficient margin between its wholesale VULA and retail SFBB prices to prevent BT from foreclosing its rivals and restricting retail competition. This is the basis on which EE would compete with BT in the supply of SFBB retail products in the counterfactual scenario. The same is true for other providers such as TalkTalk, Sky and Vodafone.

The Transaction will not result in the discriminatory prioritisation of investment decisions

16.14 The Issues Statement questions whether, as a result of the Transaction "there will be more investment in projects that are beneficial to BT/EE that will compete for resources with those that could benefit rivals; … how BT prioritises its investment in its network, and how its decisions may be influenced by the merger."[148] More specifically, third parties have alleged that BT has prioritised the rollout of fibre over the maintenance and development of BT's copper network, to the detriment of rival downstream suppliers. They allege that the Transaction will increase BT's incentive to do so.

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are in addition to the regulatory layer governing Openreach (including the imposition of EOI obligations) which inherently removes BT's ability to discriminate among downstream CPs.

147 Contrary to allegations made by third parties, BT notes that reliance on BT's wholesale GEA product to provide SFBB does not preclude scope for retail differentiation. Per Ofcom's definition of VULA, paragraph 12.4 of the 2014 FAMR statement, "VULA provides access to BT's NGA network in a way that is similar to how LLU provides access to the CGA network. However, rather than providing a physical line, *VULA provides a virtual connection that gives CPs a direct link to their customers and provides flexibility over how this link is integrated into their network and over product offerings.*" (emphasis added)

148 Issues Statement, paragraph 71.

16.15 As described in the response to the MQ, BT's ability to favour its own downstream retail businesses – through the hypothetical discriminatory prioritisation of investment decisions or otherwise – is precluded by: (i) the functional separation of Openreach from the rest of BT; (ii) regulations governing BT's wholesale business where BT has been found by Ofcom to have significant market power; and (iii) effective competition in those areas where regulation has been judged unnecessary.

16.16 The Transaction will have no effect on BT's incentive in relation to the supply of wholesale broadband services. BT currently provides fixed and mobile services and would have continued to do so in the counterfactual. In the counterfactual, BT would be a close competitor to Virgin Media, TalkTalk, Sky and other CPs for fixed and mobile services, whether sold individually or as bundle. As a result, the Transaction will not create ability or incentive to discriminate against rival downstream suppliers through investment decisions.

16.17 At any rate, it is incorrect to suggest that BT has neglected or will following the Transaction neglect to invest in the maintenance and development of copper infrastructure. Serving customers over copper infrastructure is and will continue following the Transaction to be a significant part of BT's retail broadband business. For example, BT's SFBB products are currently delivered primarily over Fibre-to-the-Cabinet (***FTTC***) technology which relies on copper infrastructure between the cabinet and the consumer residence.[149] Between 2010/11 and 2014/15 inclusive, Openreach has invested approximately [✂] in its copper network per year. This reflects between [✂] of Openreach's total annual capex. Furthermore, in that period, the highest annual spend on the Openreach fibre network, [✂], was less than the lowest annual spend on the Openreach copper network, [✂].

16.18 BT has also advanced significantly the rollout of fibre infrastructure, including in support of the state-funded Broadband Delivery UK goal of providing SFBB to at least 95% of UK premises. BT is presently upgrading 2,000-3,000 cabinets per quarter and connecting over 100,000 premises with fibre every week.[150] However, as BT's capex spends and continued practical reliance on copper show, BT remains committed to the maintenance and development of copper infrastructure. This commitment will persist following the Transaction.[151]

Conclusion

16.19 The Transaction will not diminish the effectiveness of the existing regulatory framework in which BT's wholesale broadband business operates so as to

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[149] For this reason, fibre is generally regarded as an "overlay" network that complements copper infrastructure.

[150] For more information, see http://www.superfast-openreach.co.uk/the-big-build/.

[151] In addition, BT (via Openreach) already makes investments that do not benefit BT's retail business (e.g. opening up NTE to competitive third party engineers so as to make it easier for Sky to install Sky boxes). There is no reason to expect the Transaction will change this.

ensure that all efficient downstream CPs can compete on the basis of regulated inputs and/or competitively supplied wholesale services on equal footing.

16.20 Nor will the Transaction result in the discriminatory prioritisation of the merged entity's investment decisions.

Section F - Retail Broadband

17. Introduction and summary

17.1 The Issues Statement identifies two theories of harm relating to retail broadband:

(a) the Transaction's impact on BT's incentive to increase the price or reduce the quality of broadband in rural areas where little LLU has taken place at local exchanges;[152] and

(b) the Transaction's impact on BT's ability and incentive to increase the price or reduce the quality of the retail supply of superfast broadband (***SFBB***), particularly outside Virgin Media's network area.[153]

17.2 The Transaction will not result in an SLC in the national retail broadband market. Even if there were distinct retail markets (a) for standard broadband (***SBB***) in rural areas where there is currently limited LLU and/or (b) for SFBB services, it is clear that the Transaction will not result in an SLC in either of these markets.

17.3 In relation to SBB in rural areas where there is currently limited LLU:

(a) The Transaction does not present an appreciable increment to BT's rural market shares. EE has a small [✂] share of retail broadband in rural areas. Specifically, EE's retail market share across the 2,506 exchanges at which BT is the only Principal Operator[154] (i.e. exchanges which have not been unbundled) is approximately [0-5%].

(b) EE is not currently a [✂]. This is true of both BT-branded broadband products and BT's Plusnet brand. In any case, [✂].

(c) The Transaction will not diminish the ability of established or prospective broadband suppliers to serve rural customers or to fill EE's pre-Transaction role as a WBA operator.[155]

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[152] Issues Statement at paragraph 73.

[153] Issues Statement, paragraph 77.

[154] As of March 2015. Note that Market A also includes exchanges where there is one other PO present in addition to BT.

[155] The Issues Statement notes at paragraph. 76(b) that the CMA may consider how products provided over WBA differ from those offered over LLU. From a consumer perspective, broadband products provided over WBA do not differ from those provided from unbundled exchanges. Ofcom and the Competition Commission have considered and rejected suggestions that LLU-based competition is somehow superior to WBA-based competition (see e.g. paragraphs 7.76-7.80, 7.122 and 7.145 of the March 2013 Competition Commission decision on the appeal of Ofcom's 2012 WLR and LLU charge control available at http://www.catribunal.org.uk/238-7998/Ruling-on-disposal-of-appeals.html). At any rate, EE supplies retail broadband to rural customers exclusively over WBA. Therefore, entry using WBA would be sufficient to replicate EE's pre-merger position.

17.4 Similarly, the Transaction will not result in an SLC in the retail supply of SFBB:

(a) BT's estimated 31% share of the SFBB segment is significantly smaller than Virgin Media's estimated 52% share.

(b) BT's share of the SFBB segment could not be significantly increased as a result of the Transaction. As at 31 May 2015, EE had only [✂] SFBB customers, which represents only approximately [0-5%] of the total number of 8.3 million SFBB customers in the UK. Contrary to some third party suggestions, EE's share of SFBB subscribers has not recently increased in a meaningful way.

(c) BT's relatively high SBB to SFBB conversion rate is a pre-existing feature of the retail broadband market and does not limit the ability of rival SFBB suppliers to compete. Moreover, BT will continue following the Transaction to face significant and increasing competition from rival SFBB providers.

17.5 The remainder of this section engages directly with the Issues Statement and is therefore structured as follows:

(a) Part 18 deals with market definition;

(b) Part 19 deals with theory of harm 7; and

(c) Part 20 deals with theory of harm 8.

18. Market definition

A single broadband product market at all speeds is appropriate

18.1 The Issues Statement notes that the CMA "may consider the extent to which broadband and superfast broadband (SFBB) should be considered as separate markets."[156]

18.2 BT submits that for at least the duration of the CMA's time horizon for merger review, SBB and SFBB should continue to be considered within a single product market definition. In addition to reflecting the practical way in which SFBB and SBB products are priced and marketed, this view is consistent with the forward-looking market definition adopted by Ofcom following its latest comprehensive review of the UK market, which concluded last year – and which, BT submits, holds true today. It is also consistent with the European Commission's decisional practice in its assessments of European telecommunications mergers. For example:

(a) SFBB is not likely, in Ofcom's view, to constitute a distinct product market until 2017 at the earliest.[157] Ofcom attributes this to:

[156] Issues Statement, paragraph 32.

[157] Ofcom, *2014 WBA Review*, paragraph 3.71.

(i) Evidence that average prices for SFBB relative to SBB are only marginally above 10%, with pricing in general indicating a chain of substitution.[158] In practice, retail providers continue to set SFBB prices by reference to SBB prices in an effort to dissuade SFBB customers from regarding to SBB.[159]

(ii) Evidence that SFBB is not yet considered to be a "must have" product relative to SBB.[160] Ofcom has observed on this point that although "it seems likely that some positive value is attributed to a faster speed, we remain of the view that the evidence is consistent with a single market for different speeds."[161]

(b) The European Commission has likewise concluded that SFBB and SBB exist within a single product market. Notably, in considering the appropriate product market definition in *Vodafone / Ono* the European Commission concluded that "the increase in speeds [brought about by SFBB] is a sign of evolution of the market, rather than the creation of a new separate market."[162]

(c) Finally, in the UK merger control context, Ofcom's characterisation of the product market was considered favourably by the OFT in its 2013 assessment of the *British Sky Broadcasting Limited / Be Un Limited* transaction. The OFT noted specifically that Ofcom's view of a single product market including both SBB and SFBB was supported by the parties to that transaction and third party competitors alike.[163]

18.3 In any case, as set out in BT's response to the MQ, the Transaction will not give rise to any competitive concerns even under the narrowest possible product market definition. It is not therefore necessary for the CMA to conclude definitively on the scope of the relevant product market.

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[158] Ofcom, *2014 WBA Review,* paragraphs 3.43-3.47.

[159] Moreover, Sky now offers a capped SFBB product "free for 12 months": see https://corporate.sky.com/media-centre/news-page/2015/sky-launches-best-ever-fibre-deal.

[160] Ofcom, *2014 WBA Market Review*, paragraph 3.66.

[161] Ofcom, *2014 WBA Market Review*, paragraph 3.55. Ofcom reports also that average ADSL speeds have reached 7.3MBit/s as of November 2014 (http://media.ofcom.org.uk/news/2015/broadband-speeds-november2014/). Average speeds of 7.3Mbit/s are in BT's view capable of accommodating all (including streaming high definition video) but the most data intensive applications.

[162] *Case No. COMP/M.7231*, paragraph 16.

[163] See e.g. *ME/5913/13 British Sky Broadcasting Limited / Be Un Limited,* paragraph 19.

A national geographic market is appropriate

18.4 The Issues Statement notes that the CMA "may consider 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)."[164]

18.5 While the nature of demand for retail broadband is inherently local, BT submits that a national geographic market is appropriate. While EE, BT Plusnet and some other retail suppliers have adopted geographically differentiated pricing policies broadly along Market B / Market A lines, BT sets its BT-branded broadband prices on a national basis, as do other suppliers such as The Post Office and John Lewis. BT-branded broadband products are priced on a national basis by reference to the competitive constraints in Market B (which accounts for approximately 90% of UK premises). Presumably, The Post Office and John Lewis take the same view. Given the need to remain price competitive nationally with aggressive national rivals such as Sky, TalkTalk and Virgin Media, BT's and these other operators' national pricing policies and national advertising campaigns serve as an effective constraint on broadband prices in rural areas (which account for only 10% of UK premises) regardless of local market conditions. This suggests that a national market definition is appropriate.

18.6 Ultimately, the Transaction will not result in a meaningful change to the structure of competition in the supply of retail broadband in any geographic region of the UK. It is therefore not necessary for the CMA to reach a definitive position on the scope of the relevant geographic market.

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

19.1 The Issues Statement identifies a theory of harm relating to the Transaction's impact on BT's incentive to increase the price or reduce the quality of SBB in rural areas where little LLU has taken place at local exchanges.[165]

19.2 As set out in the response to the MQ, the Transaction will not result in an SLC in the retail supply of broadband in rural areas:

(a) As set out at paragraph 18.5, while the nature of demand for retail broadband is inherently local, a national geographic market definition is appropriate. (Nevertheless, BT also presents rural market shares below.)

(b) The Transaction does not present an appreciable increment to BT's rural market shares or market share accretion. EE has a small [✂] share of retail broadband in rural areas. Specifically, EE's retail market share across the 2,506 exchanges at which BT is the only Principal

[164] Issues Statement, paragraph 32.

[165] Issues Statement at paragraph 73.

Operator[166] (i.e. exchanges which have not been unbundled) is approximately [0-5%].

(c) Moreover, EE is not currently a [✂]. This is true of both BT-branded broadband products and BT's Plusnet brand. In any case, EE's pre-Transaction business plans anticipate that [✂].[167] Any hypothetical competitive pressure that EE may have exerted on BT would therefore have been removed independently of the Transaction. Furthermore, there are a minimum of two other active retail broadband suppliers in addition to BT and EE at all but three of the rural exchanges from which EE currently supplies broadband.

(d) The Transaction will not diminish the ability of established or prospective broadband suppliers to serve rural customers or to fill EE's pre-Transaction role as a WBA operator.[168] The regulation of BT's wholesale broadband copper products in rural areas ensures that all efficient downstream operators can compete on the basis of regulated inputs. By way of example, Fleur Telecom's 2014 purchase of TalkTalk's off-net customer base demonstrates Fleur Telecom's confidence that wholesale regulation will enable it to serve its newly acquired customers effectively.[169] BT's acquisition of EE will not affect or diminish in any way the effectiveness of these regulations. Furthermore, the ongoing rollout of fibre broadband to rural areas facilitated in part by the Broadband Delivery UK initiative, coupled with the regulation of BT's supply of wholesale fibre broadband inputs, provides BT's rivals with an increasingly important additional means to serve broadband customers in rural areas.

The Transaction does not present an appreciable competitive overlap in rural areas

19.3 The Issues Statement notes that the CMA "may clarify market shares across different exchange types, the number of exchanges where BT and EE are

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166 As of March 2015. Note that Market A also includes exchanges where there is one other PO present in addition to BT.

167 I.e. within WBA Market A.

168 The Issues Statement notes at paragraph. 76(b) that the CMA may consider how products provided over WBA differ from those offered over LLU. From a consumer perspective, broadband products provided over WBA do not differ from those provided from unbundled exchanges. Ofcom and the Competition Commission have considered and rejected suggestions that LLU-based competition is somehow superior to WBA-based competition (see e.g. paragraphs 7.76-7.80, 7.122 and 7.145 of the March 2013 Competition Commission decision on the appeal of Ofcom's 2012 WLR and LLU charge control available at http://www.catribunal.org.uk/238-7998/Ruling-on-disposal-of-appeals.html). At any rate, EE supplies retail broadband to rural customers exclusively over WBA. Therefore, entry using WBA would be sufficient to replicate EE's pre-merger position.

169 Fleur Telecom currently has [✂] as many rural broadband customers as EE.

present with only limited other competition present, and the variation in prices."[170]

19.4 The acquisition of EE's broadband subscriber base will result in only a small increment to BT's current position. While BT maintains that a national geographic market definition is appropriate, EE's share of broadband subscribers is small even if the market is considered on a sub-national basis:

(a) EE's market share across the 2,506 exchanges at which BT is the only Principal Operator (i.e. exchanges which have not been unbundled) is approximately [0-5%].

(b) Notably, as set out in the data BT provided in response to the CMA's RFI of 12 May 2015, there are no exchanges where BT and EE are the only active retail suppliers. There are in fact a minimum of two other active retail broadband suppliers in addition to BT and EE at all but three of the non-unbundled exchanges from which EE supplies broadband.[171]

19.5 The Transaction does not therefore present an appreciable competitive overlap. As a result, BT's acquisition of EE's broadband subscriber base will not change meaningfully the supply of broadband to customers, even in rural areas.

EE is not [✂] in rural areas

19.6 The Issues Statement notes that the CMA "may assess how competition and pricing works at these 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."[172]

19.7 As set out in BT's response to the MQ, EE is not a [✂]. This is true of both BT-branded broadband products and BT's Plusnet brand:

(a) BT prices its BT-branded SBB and SFBB products on a national basis. Furthermore, [✂].[173] Contrary to suggestions made in some third party submissions, the increase in EE's national share of SFBB subscribers from [0-5%] in [✂] to [0-5%] in [✂] has not changed [✂].

(b) BT's Plusnet brand differentiates SBB and SFBB pricing geographically by "low cost" (i.e. all exchanges within WBA Market B and 618 exchanges within WBA Market A that were unbundled as of

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170 Issues Statement, paragraph 76.

171 There are no exchanges from which BT and EE are the only active retail providers. As described below, Fleur Telecom's successful entry as a retail broadband supplier exclusively serving rural areas demonstrates that it is misleading to suggest that only "national providers" should be considered as competitors within rural areas.

172 Issues Statement, paragraph 76.

173 As set out in the response to the MQ, EE's broadband prices in rural areas are in fact more expensive than BT's.

late 2014) and "non-low cost" (i.e. exchanges within WBA Market A that were not unbundled as of late 2013) areas [✂], it is not plausible to suggest that the Transaction would impact on Plusnet's future pricing in these areas.

(c) As set out in EE's response to the MQ, EE's SBB offering in Market A is more expensive than that of its competitors.[174]

19.8 In addition to price, BT submits that EE [✂] on quality of service. Ofcom's most recently published data on the volume of complaints made to Ofcom against the major providers of telecoms and pay TV services shows that EE generated the most complaints for broadband as a proportion of its customer base.[175] This reflected an increase in complaints about EE's broadband products since Q4 2014, and the highest level of complaints received since Q1 2013. The main drivers of complaints to Ofcom about EE's broadband products related to: (a) faults, service and provision (37%); (b) billing, pricing and charges (20%); and (c) complaints handling (20%). These data support the view that EE does not constrain the non-price aspects of BT's supply of broadband to retail customers. By contrast, suppliers such as Sky and Fleur Telecom[176] focus on and promote the quality of their broadband service in rural areas. As such, there is no basis on which to conclude that the merged entity may have an incentive to reduce quality of broadband in rural areas.[177]

19.9 In any case, [✂].

The Transaction will not diminish the ability of other operators to serve customers in rural areas

19.10 The Issues Statement notes that the CMA "may investigate the ability and plans of other operators to provide a retail offer at the exchanges in question."[178]

19.11 As set out in the response to the MQ, the Transaction will not diminish the ability of other operators to serve customers in rural areas, and in particular those areas where there has been little unbundling of local exchanges.

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174 See EE's response to MQ Question 21 for details of EE's pricing.

175 See e.g. http://stakeholders.ofcom.org.uk/market-data-research/other/telecoms-research/complaints/Q1-2015/.

176 Sky currently promotes as a reason for using its rural broadband "Sky Connect" service that Sky offers the "*Best combined overall customer service for Sky Broadband and Talk, compared with BT, Virgin Media and TalkTalk*". See http://www.sky.com/shop/broadband-talk/broadband-connect/ . Fleur Telecom also promotes the fact that it is "*a communications provider that is dedicated to providing our customers with great value, high quality connectivity underpinned by UK-based customer support … with the majority of our customers based in rural locations*." See http://fleurtelecom.co.uk/.

177 Issues Statement, paragraph 73.

178 Issues Statement, paragraph 76.

19.12 Ofcom's 2014 review of the wholesale broadband access market concluded that BT has SMP at exchanges where there has been little unbundling of local exchanges. In determining the appropriate scope of regulation to address this SMP, Ofcom took account of its regulatory experience from previous WBA market reviews, developments in the supply of WBA, developments in the supply of LLU-based services, and the views expressed by stakeholders during consultations in 2013 and 2014. Ofcom concluded that BT's SMP in these rural areas would be effectively addressed by imposing upon BT requirements to:[179]

(a) provide network access on reasonable request, and not to discriminate among downstream purchasers by supplying access on an equal access (EOI) basis;[180]

(b) comply with various transparency obligations, including requirements to:

(i) publish a reference offer setting out prices, terms and conditions (to assist with transparency in monitoring potential anti-competitive behaviour and to give visibility to the terms and conditions on which other CPs would be able to purchase wholesale services);

(ii) publish any planned changes to charges in advance of those charges taking effect;

(iii) publish relevant technical information in advance of providing new wholesale services or amending existing technical terms and conditions;

(iv) maintain transparency as to quality of service;

(v) provide financial statements with separate reporting for internal and external activities; and

(c) comply with a charge control on a CPI-10.7% basis in relation to BT's IPStream Connect Max and Max Premium anchor products (plus various safeguard sub-caps).[181]

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[179] A detailed description of these remedies is available in the *2014 WBA Review*, sections 6 and 7.

[180] Notably, this is the only example of an equal access obligation being imposed on BT downstream of Openreach. The implication of this is that all providers, including BT's own retail operations, have access to exactly the same wholesale broadband products in rural areas. As a result, all efficient CPs can compete on the same basis of regulated inputs. There are therefore no wholesale barriers to entry.

[181] Ofcom, *2014 WBA Review,* paragraphs. 7.1 and 7.10. Ofcom has imposed a charge control on the IPstream Connect Max and Max Premium products on the basis that they are: (i) supplied over legacy technology; and (ii) the products most used by end users in Market A. Ofcom concludes therefore that charge controlling these products directly protects most consumers in Market A and constrains BT from excessive charging on the other products available in Market A (paragraph 7.1).

19.13 As described in its response to the MQ, BT's supply of wholesale SFBB inputs is also subject to comprehensive requirements that preclude any ability to foreclose downstream retail SFBB suppliers.[182] A summary of the requirements imposed by Ofcom on BT's supply of wholesale SFBB inputs is set out in Section E. In addition to wholesale regulation by Ofcom, much of the investment in rural SFBB is being undertaken with funding from government grants, which are subject to stringent open access obligations in order to comply with State aid rules.

19.14 Collectively, these regulations ensure that all efficient downstream operators can compete in respect of copper and fibre (where it is available) on equal terms on the basis of regulated inputs.

19.15 A representative example of the effectiveness of these regulations is Fleur Telecom's recent entry as a WBA operator in rural areas. Formed in 2014, Fleur Telecom advertises itself as having a "strong focus on customers within more 'hard to reach' areas" and offers a selection of broadband packages differentiated by unlimited data usage, the Fleur Security Suite and customer service focused on rural customers. Fleur Telecom recently acquired TalkTalk's approximately 136,000 off-net subscribers, and offers retail broadband products that are considerably less expensive than EE's. The Post Office also targets customers in rural areas. Notably, according to market commentators, The Post Office "uses TalkTalk's low cost network where this is available, but these savings are passed on to all customers so you'll enjoy the same low prices even if you live in more rural or remote areas."[183]

19.16 These examples illustrate that established and prospective broadband suppliers have the appetite and ability to serve customers in rural areas.[184] Moreover, if the merged entity attempted an appreciable and non-transient increase in retail prices in rural areas, Sky, Virgin Media, TalkTalk[185] and other established and prospective suppliers could readily make use of the regulated wholesale inputs to offer competing broadband products and erode BT's share.

19.17 The Transaction will not impact the application or effectiveness of these regulations nor, therefore, the ability of established and prospective operators to serve rural areas. BT will continue to be required to supply wholesale broadband inputs (both copper and fibre) to downstream CPs in the manner that Ofcom has concluded ensures that all efficient CPs can compete. As a result, the Transaction will not provide BT with an ability to diminish the ability of other operators to serve broadband customers in rural areas.

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[182] Ofcom, *Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30 statement* [2014 FAMR statement], paragraph 12.1.

[183] See e.g. http://www.broadband.co.uk/broadband/providers/post-office/.

[184] As noted above, EE supplies retail broadband in rural areas exclusively via WBA. As a result, entry via WBA (which is entirely feasible as demonstrated by Fleur Telecom) would be sufficient to replicate EE's pre-Transaction position.

[185] Subject to any contractual non-compete obligations to Fleur Telecom in connection with the sale to Fleur Telecom of TalkTalk's off-net customers.

Conclusion

19.18 While BT and EE are both engaged in the supply of broadband products to customers in rural areas, BT's acquisition of EE will not result in an SLC. EE possesses only a small share of the retail fixed broadband in these areas. [✂] Additionally, regulation of BT's wholesale services will continue to ensure that all efficient CPs can compete downstream on the basis of regulated inputs.

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

20.1 The Issues Statement identifies a theory of harm relating to the Transaction's impact on BT's ability and incentive to increase the price or reduce the quality of the retail supply of SFBB, particularly outside of Virgin Media's network area.[186]

20.2 The Transaction will not result in an SLC in the retail supply of SFBB:

(a) While the nature of demand for retail broadband is inherently local, a national geographic market definition is appropriate: see paragraph 18.5. And considered on a national basis, BT's estimated 31% share of SFBB supply is significantly smaller than Virgin Media's estimated 52% share.

(b) As set out in Section 18, SFBB is and will continue to be constrained by SBB. BT agrees with Ofcom's view that a single product market including both SBB and SFBB is appropriate until 2017 *at the earliest*.

(c) BT's share of SFBB supply could not be "significantly increased"[187] as a result of the Transaction. This is true regardless of whether the relevant geographic market is considered to be national or subnational along the boundaries of Virgin Media's network area:[188]

(i) First, as at 31 May 2015, EE had only [✂] SFBB customers, which represents only approximately [0-5%] of the 8.3 million SFBB customers in the UK. Moreover, EE provides SFBB services using regulated wholesale SFBB inputs from Openreach. In Q4 2014/15, Openreach reported a total fibre broadband base of 4.193 million customers.[189] As such, even excluding all Virgin Media customers, EE's [✂] SFBB customers represents less than [0-5%] of the total base of SFBB customers served by Openreach inputs.

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186 Issues Statement, paragraph 77.

187 Issues Statement, paragraph 77(b).

188 As described in the response to Theory of Harm 7, BT maintains that a national geographic market is appropriate. Nevertheless, to assist in the CMA's review BT has distinguished in this section between areas within and outside of Virgin Media's network area.

189 See http://www.btplc.com/Sharesandperformance/Quarterlyresults/2014-2015/Q4/Downloads/KPIs/q415-KPIs.pdf, page 8.

(ii) Second, contrary to some third party suggestions EE's share of SFBB subscribers has not seen a substantial recent increase. In fact, EE's SFBB share has changed from [0-5%] in [✂] to [0-5%] in [✂]. This represents a net increase of approximately [✂] customers over two years. By contrast, in just the first quarter of 2015 Virgin Media and TalkTalk gained 148,000 and 83,000 SFBB net adds, respectively,[190] and Sky is aggressively marketing its Sky Fibre SFBB product. The Transaction will not therefore result in an appreciable increase to BT's existing position.

(iii) Third, BT's supply of wholesale SFBB inputs is highly regulated. Pursuant to the VULA margin regulation, BT is required to supply wholesale SFBB inputs to downstream CPs in the manner that Ofcom has concluded ensures that all efficient CPs can compete on equal footing. Moreover, Ofcom's VULA margin regulation "bites" on BT's retail pricing of SFBB as well as on BT's upstream pricing of wholesale SFBB inputs. Taken together, these pricing safeguards protect rival VULA-based SFBB providers from anticompetitive levels of price competition from BT at the retail level.[191] As set out in paragraph 16.4, Ofcom has applied and found that BT has passed the VULA margin squeeze test during the first assessment period.[192] The Transaction will not therefore enable BT to increase its SFBB market share by reducing the ability of rival SFBB suppliers to compete.

(d) BT's relatively high SBB to SFBB conversion rate is a pre-existing feature of the retail broadband market and does not limit the ability of rival SFBB suppliers to compete. Within the context of its extensive market review regime, Ofcom has reviewed carefully the supply of wholesale SFBB inputs and has imposed specific ex ante regulatory obligations on BT to ensure that all efficient rival SFBB suppliers are likewise able to convert SBB customers.

(e) BT will continue following the Transaction to face significant and generally increasing competitive pressure from other SFBB providers. Importantly, Virgin Media – which holds an estimated 52% of the SFBB subscriber base – is committed to the rapid expansion of its SFBB network area. Virgin Media's most recent expansion was announced as "the single largest investment in broadband digital

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190 Enders, *UK broadband, telephony and pay TV trends Q1 2015*, 24 June 2015, page 8.

191 See Section E.

192 See http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/cases-in-compliance/bt-compliance-vula-margin-control/?utm_source=updates&utm_medium=email&utm_campaign=vula-margin-control.

infrastructure in the country for more than a decade."[193] The expansion will extend Virgin Media's "unrivalled fibre-rich network" to approximately four million additional premises over the next five years. This expansion will increase the number of homes and businesses within the Virgin Media network area "by almost a third; from around half of the country today to nearly 17 million premises by 2020." Furthermore, other competing SFBB suppliers, including Sky, TalkTalk and Vodafone, amongst others, also plan to make major inroads into the SFBB segment, including in areas outside Virgin Media's current network area. There is also increasing rollout of SFBB networks by alternative infrastructure providers such as Gigaclear and Hyperoptic.

SFBB is and will continue to be constrained by SBB

20.3 The Issues Statement notes that the CMA is "likely to investigate whether SFBB is and will continue to be constrained by broadband [SBB], or whether it should be considered a separate market."[194]

20.4 For the reasons set out above, Ofcom has, following its latest exhaustive market review, recently found that SFBB is and will continue to be constrained by SBB until 2017 at the earliest. The uncertainty as to if and when SFBB develops into a distinct product market means that it would be highly speculative for the CMA to consider SFBB as a distinct product market for the purposes of this review – particularly in the absence of evidence of such segmentation to date.

BT's share of the SFBB segment could not be significantly increased as a result of the Transaction

20.5 The Issues Statement notes at paragraphs 77 and 78(b) that third parties have alleged that relatively few competitors constrain BT's position in SFBB outside Virgin Media's network area.[195] They allege further that BT's position in SFBB will be strengthened following the Transaction by converting EE's SBB customers to SFBB. The Issues Statement notes that the CMA is "likely to investigate 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."[196]

20.6 First, the Transaction could not significantly increase BT's share of the SFBB segment; see paragraph 20.2(c) above.

20.7 In any event, BT agrees with comments by third parties that the retail broadband market is in a state of transition. The CMA should therefore place a

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[193] See http://about.virginmedia.com/press-release/9467/virgin-media-and-liberty-global-announce-largest-investment-in-uks-internet-infrastructure-for-more-than-a-decade.

[194] Issues Statement, paragraph 78.

[195] As noted above, BT submits that a national market covering all broadband speeds is the appropriate market definition.

[196] Issues Statement, paragraph 78.

lower weight on current SFBB shares until the SFBB segment matures.[197] All the more so as BT's relatively high share of subscribers receiving SFBB over Openreach NGA (i.e. outside the Virgin Media network area) reflects BT's commercial decision to invest early in the retail supply and promotion of SFBB – a strategy that was available to rival suppliers given the availability of regulated Openreach inputs but which they have only more recently started to implement.

20.8 Second, BT's supply of wholesale SFBB inputs is highly regulated, such that BT has no ability to foreclose access to essential wholesale inputs to SFBB. As set out in Section E, these regulations include, among other things: constraints on the margin between BT's wholesale and retail SFBB prices; and requirements to provide VULA (i) on fair and reasonable terms, conditions and charges, (ii) on an EOI basis, and (iii) without any undue discrimination among downstream CPs. BT's SFBB share could not therefore be significantly increased by foreclosing wholesale SFBB inputs.

20.9 Third, Virgin Media is rapidly expanding the coverage of its network area; see paragraph 20.2(e) above. As a result of Virgin Media's commitment to the rapid expansion of its network area and the factors favouring a national geographic market, BT submits that hypothetical concerns relating to SFBB competition outside Virgin Media's network area should not be an area of primary focus in the CMA's review.

The retail broadband market is in transition

20.10 The Issues Statement notes that the CMA is interested in "the extent to which SFBB customers are acquired through upgrade rather than switching between alternative providers."[198]

20.11 BT acknowledges that, as set out in its response to the MQ, a majority of BT's SFBB customers have been acquired by upgrading existing SBB accounts. BT attributes this to the nascent nature of the SFBB segment. Competition for SFBB subscribers among rival suppliers will likely become more prevalent as the SFBB segment matures.

20.12 Third parties have suggested that following the Transaction, EE's SBB customers will be quickly upgraded to SFBB. It is unclear how this could result in an SLC. The acquisition (and hypothetical conversion to SFBB) of EE's small SBB subscriber base will result in only a small increment to BT's pre-Transaction SFBB position (even on the unsupported assumption that these customers will all be converted to a BT SFBB product). There is no certainty that BT will be able to upgrade EE's SBB subscriber base following the Transaction, given EE's inability to convert these subscribers to SFBB to date.

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[197] BT also notes that the VULA regulation explicitly includes provisions aimed at reducing retail customers' costs of switching between VULA-based SFBB providers (see Ofcom, *Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30 statement* at paragraph 12.1).

[198] Issues Statement, paragraph 78.

20.13 Some third parties have also drawn attention to BT's historically high share of the net additions to the fibre network outside Virgin Media's network area. Any elevated share that BT may have historically held was attributable to BT's commercial decision to promote fibre products actively from the outset. Importantly, BT Openreach's wholesale SFBB inputs were (and remain) available to all prospective downstream suppliers on equal access terms; other retail providers simply chose not to market SFBB until demand for SFBB products had become apparent. Having recently made the commercial decision to enter the SFBB segment, these rival suppliers have shown that they can sell SFBB in large volumes as easily as BT (and Virgin Media).

BT will continue to face competitive constraints in SFBB following the Transaction

20.14 Finally, the Issues Statement notes that the CMA is "likely to investigate the extent of competitive constraints in SFBB absent the merger, including EE's plans."[199]

20.15 As set out above and in the response to the MQ, EE is not [✂] in the SFBB segment, including in the area outside Virgin Media's large and expanding network area.[200]

20.16 EE is not especially price competitive on SFBB. For example:

(a) EE's standard 38MB fibre monthly rental price for an 18 month contract is £19.95. TalkTalk's and Vodafone's newly launched services are both priced at £15, and BT charges £14.99 through its Plusnet brand and £12.50 for a 12 month contract on BT-branded products. Virgin Media charges £17.50 for a like product over the same period.

(b) While EE has an introductory half price offer for the first six months at £9.99 per month, this is overshadowed by Sky's offer of free SFBB for 12 months followed by £10 per month.[201] TalkTalk offers its service at £10 per month for the first 12 months, Vodafone at £7.50 per month for 12 months for existing Vodafone customers, Virgin for £5 per month for the first 12 months and BT for free for the first 6 months through its Plusnet brand.

20.17 As set out in paragraph 19.8, EE is likewise not especially competitive on the non-price components of the supply of SFBB. The acquisition of EE will therefore not change in a meaningful way the competitive pressure exerted upon BT's SFBB business.

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199 Issues Statement, paragraph 78.

200 EE also has a much smaller overall broadband base compared with Sky, TalkTalk and Virgin Media. There is no reason that EE would have expected to do better in relation to SFBB than it has done in relation to SBB, or that the EE subscriber base is not contestable by these and other rival suppliers.

201 This offer relates to capped SFBB. Sky's fully uncapped SFBB product is available for £10 per month.

20.18 In addition, the merged entity will face significant and generally increasing competitive pressure from other SFBB suppliers and alternative infrastructure providers. In particular:

(a) *Virgin Media*. The announcement of Virgin Media's major network expansion (see paragraph 20.2(e) above) notes also that customers "connecting to Virgin Media for the first time will benefit from broadband speeds of 152Mb, at least twice as fast as the fastest speeds available from BT, TalkTalk and Sky."

(b) *Sky*. Sky is committed to aggressive expansion in the SFBB segment, most recently evidenced by the launch of capped SFBB free for 12 months.[202] Advertised as "the first time that any major broadband provider has offered a whole year of superfast speeds at such a low price," the offer is available to any customer switching to Sky Fibre (Sky Fibre is available to 80% of UK homes). Moreover, a one year contract means that there is no obligation beyond the free period. In advertising this Sky Fibre offer, Sky directly references competing offers from BT and highlights also that Ofcom has found Sky to have the most reliably consistent speeds.

(c) *Vodafone*. Vodafone recently announced the start of "its journey of becoming one of the UK's leading providers of consumer communications and entertainment services"[203] with the launch of an uncapped SFBB Vodafone Connect product. The announcement highlighted that "Vodafone's nationwide, fibre optic, business-grade network already reaches exchanges which pass nearly 20 million premises across the UK: with that figure increasing to around 22 million later in the summer." Vodafone SFBB is advertised to existing Vodafone customers for £7.50 per month for the first 12 months.[204] In addition, Vodafone recently launched an "ultrafast" variant of the Vodafone Connect product with speeds up to 76Mbps is available to existing Vodafone customers for £10.00 per month for the first 12 months.

(d) *TalkTalk*. TalkTalk is also aggressively targeting the SFBB segment with comparative advertisements highlighting its uncapped SFBB products ("unlike Sky and BT, all our Fibre packages are unlimited") and hardware ("with faster wireless speeds than BT, Virgin, EE & Sky routers"). TalkTalk's SFBB product is advertised for £10 per month for the first 12 months. As of 28 July 2015, prospective customers also receive a £50 voucher for purchasing TalkTalk's SFBB product online. TalkTalk's success in the SFBB segment is illustrated by the increase

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202 See https://corporate.sky.com/media-centre/news-page/2015/sky-launches-best-ever-fibre-deal.

203 See https://www.vodafone.co.uk/cs/groups/configfiles/documents/assets/vfcon063787.pdf.

204 See http://www.vodafone.co.uk/broadband/.

in its SFBB net adds from 35,000 customers added during December 2013 to 88,000 customers added during December 2014.[205]

(e) *Hyperoptic*. Hyperoptic is advertised as the UK's leading Fibre-to-the-Premises (***FTTP***) broadband provider and was recognised recently by the Internet Services Providers' Association as having the "Best Superfast Broadband" for the third year in a row.[206] Hyperoptic's continued innovation in the SFBB segment is illustrated, for example, by the recent announcement of a 'no-contract' SFBB product to new customers.[207] With 1Gb speeds and standalone broadband options available, Hyperoptic "is redefining the broadband market with unprecedented speeds and flexible packages, enabling its customers to live their online lives to the maximum, without compromise."

Conclusion

20.19 The Transaction will not result in an SLC in the supply of SFBB to retail customers, including outside Virgin Media's expanding network area. BT's acquisition of EE's consistently small share of the SFBB subscriber base will not change the competitive landscape. In addition, the regulation of BT's supply of wholesale SFBB inputs precludes any ability by BT to foreclose rival downstream SFBB suppliers in a manner that could result in an SLC. Finally, consumers will continue to benefit from robust competition in the retail supply of SFBB from a range of suppliers active inside and outside Virgin Media's network area.

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[205] See e.g. Enders Analysis, *UK broadband, telephony and pay TV trends Q4 2014,* 27 February 2015, page 10.

[206] See https://hyperoptic.com/news/hyperoptic-scoops-best-superfast-broadband-ispa-award-for-third-year-running/.

[207] See https://hyperoptic.com/news/hyperoptic-pioneers-no-contract-fibre-broadband/.

Section G - Other

21. Coordinated effects

21.1 The Parties welcome the CMA's acknowledgement that it would be unlikely that the Transaction would increase the likelihood of coordinated effects. The Parties agree that this is the case in respect of all relevant affected markets.[208]

21.2 The Parties submit that, for the reasons set out in this response and in the Parties' previous submissions, the market characteristics which the CMA considers to be conducive to coordination are not materially present in any of the relevant affected markets and the Transaction would not increase the likelihood of coordinated effects:[209]

(a) There would be no ability for market participants to reach and monitor the terms of coordination, as all relevant affected markets are highly competitive and market participants seek to offer differentiated products;

(b) Coordination would not be internally sustainable in such dynamically competitive markets; and/or

(c) Coordination would not be externally sustainable having regard to factors such as possible entry or expansion, and countervailing buyer power (e.g. in relation to wholesale markets).

21.3 Moreover, the fact that the merged entity will provide both fixed and mobile products does not increase the likelihood of coordination. Whilst there are other providers that also offer, or plan to offer, both fixed and mobile products each of the providers have different strategies and competitive strengths and there will continue to be a wide variety of different fixed and mobile products on offer, undermining the potential for market coordination.

22. Conglomerate effects

22.1 The Parties welcome the CMA's acknowledgement that it would be unlikely that the Transaction would result in any conglomerate effects. The Parties agree that this is the case.[210]

(a) The Parties will not have significant market power in any of the retail markets in which they operate. These are highly competitive markets with numerous vigorous competitors.

(b) Rivals (and new entrants) would be able to replicate any bundle formed by the merged entity, due to the availability of either regulated or competitive wholesale inputs into the components of any retail bundle.

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[208] See also Annex J of the Merger Notice.

[209] As described in the *OFT (CMA) Merger Assessment Guidelines*, September 2010, section 5.5.

[210] As set out in detail in Annex L of the Merger Notice.

(c) There would not be any effect on end customers, even if the merged entity did attempt to leverage its position in one part of a bundle into another. Rivals would be unlikely to be marginalised due to their own advantages (such as Sky's position in pay TV and Virgin Media's position in broadband). Furthermore, a significant number of customers will still have a preference for unbundled products.

Section H – Efficiencies

23. Efficiencies

23.1 The Transaction takes place against the backdrop of a dynamic and highly competitive UK telecoms sector. The speed of evolution is illustrated by the following developments, all of which have been announced or implemented in the last few months:

(a) Vodafone launched a new consumer fixed broadband service in June 2015, marking a re-entry into the fixed broadband space.[211] Vodafone is over halfway through its Europe-wide £19 billion investment into its network (Project Spring) which enables high capacity broadband and backhaul and which is expected to be complete by March 2016.[212]

(b) Sky signed an MVNO agreement with O2 in January 2015, which will allow it to enter retail mobile and also offer quad play services.[213]

(c) TalkTalk announced an MVNO agreement with O2 in November 2014 (moving from Vodafone), which allows it to become a 'full' MVNO, making use of its own network and with plans to launch 4G femtocells.[214]

(d) Virgin Media announced a £3 billion investment into its network in February 2015, aiming to pass 4 million extra premises over the next five years.[215]

23.2 Furthermore, Hutchison and O2 announced a proposed merger in March 2015, while Vodafone and Liberty Global confirmed in June 2015 that they are in talks about an asset swap.[216]

23.3 As set out in sections B – G above, BT considers that there is no prospect of an SLC as a result of any of the theories of harm set out in the Issues Statement. Nevertheless, for completeness, BT sets out below details of efficiencies and customer benefits arising from the Transaction which should be taken into account by the CMA.[217] Against the background of the market changes in paragraph 23.1 above, it is clear that the merged entity will need to

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[211] http://blog.vodafone.co.uk/2015/06/10/vodafone-connect-broadband/

[212] See pages 6 and 16 of Vodafone's Annual Report 2015 http://www.vodafone.com/content/annualreport/annualreport15/assets/pdf/full_annual_report_2015.pdf.

[213] https://corporate.sky.com/media-centre/news-page/2015/sky-announces-plans-to-enter-mobile-sector

[214] http://www.techweekeurope.co.uk/mobility/4g/talktalk-business-fibre-4g-converged-158982

[215] http://about.virginmedia.com/press-release/9467/virgin-media-and-liberty-global-announce-largest-investment-in-uks-internet-infrastructure-for-more-than-a-decade

[216] http://www.ft.com/cms/s/0/d45ddf0a-0b51-11e5-8937-00144feabdc0.html#axzz3hGrOd6K4

[217] See also Section A of BT's Initial Submission, paragraphs 4.2 - 4.7.

continue to innovate and offer better value for customers in order to compete. BT considers that the following customer benefits will only arise as a result of the Transaction:

(a) A substantial proportion of BT's expected cost synergies will be returned to customers in the form of better value products, innovation and improved services. BT expects cost synergies of £3.0 billion net of integration costs. These will arise in a timely fashion - £360 million p.a. of opex and capex synergies in the 4th full year post completion, are a direct result of the Transaction and will be shared with customers. These cost synergies will give the merged entity an increased investment capacity to further develop and deploy new networks and services, including converged fixed-mobile offerings, to the benefit of consumers.

(b) BT will gain greater end-to-end control over future investment and product innovation, allowing it to deploy investment more efficiently, benefitting customers. The combination of BT's and EE's complementary knowledge bases will lead to innovative product and service offerings in fixed line, mobile and converged services. These would either not be possible at all, or would be less certain absent the Transaction, [✂]. Given the speed of change in the market, BT and EE will need to continue to differentiate their services to attract customers.

(c) The Transaction derisks and accelerates BT's mobile strategy. BT has already launched its consumer mobile service as an MVNO and would continue to try to build up its business over time. However, the Transaction allows BT to become a more effective competitor more quickly, bringing innovative ideas (such as its inside-out strategy) to consumers sooner than would be possible absent the Transaction: the Transaction will reduce the risks associated with BT's plans to provide femtocells to users, by eliminating the need to [✂]. This increases the likelihood that users will enjoy the improved quality of connectivity provided by femtocells.

23.4 As set out in Section A of BT's Initial Submission, paragraphs 4.5 – 4.7, the Transaction will also lead to efficiencies which will increase competition in the market, directly benefiting consumers, such as through cross-selling and elimination of double marginalisation.

(a) To the extent that some consumers have one-stop shopping preferences across fixed and mobile products and/or view such products as complementary, the Transaction creates a stronger incentive to price each stand-alone fixed product more aggressively as this may attract users who may also buy mobile products and vice versa.

(b) The Transaction will eliminate double marginalisation in relation to the incremental mobile sales, providing the merged entity with a stronger incentive to price those additional sales more aggressively.

23.5 These efficiencies and customer benefits can only occur, or are significantly accelerated, as a result of the Transaction. The Parties consider that the pro-

competitive effects of the Transaction are clear and that consumers will be able to benefit from the improved and innovative services which the Transaction will bring about.