

Anticipated acquisition by Tiscali UK Holdings Limited of the Broadband and Voice Division of Pipex Communications plc

The OFT's decision on reference under section 33(1) given on 17 August 2007. Full text of decision published on 31 August 2007.

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

PARTIES

1. **Tiscali UK Holdings Limited** (Tiscali UK) is a wholly owned subsidiary of Tiscali S.p.A., an independent European telecommunication company incorporated in Italy. Tiscali UK principally provides retail broadband and dial-up internet access services and voice telephony services to residential and business customers.
2. **Pipex Communications Plc** (Pipex) is the parent company of Pipex Internet Limited, Pipex Homecall Limited, Toucan Residential Limited, Toucan Residential Ireland Limited and Switch2 Telecoms Limited (together, the Pipex Broadband and Voice Division).¹ Pipex Broadband and Voice Division's principal activity in the UK is the supply of retail broadband and dial-up internet access and voice telephony communications services, operating under the following brands: Bulldog, Nildram, Pipex, Toucan and Freedom2Surf. Pipex Broadband and Voice Division's UK turnover for the year ended 31 December 2006 was £231 million.

TRANSACTION

3. Tiscali UK (or its subsidiary nominee, Tiscali UK Limited) proposes to acquire the entire issued share capital of Pipex Broadband and Voice Division, including all of the subsidiaries, pursuant to a share sale and purchase agreement.

¹ The Pipex Broadband and Voice division also contains the following subsidiaries: Freedom to Surf Limited, Freedom to Surf Registration Services Limited, Freedom to Surf Consumer Services Limited, AccentUK Limited, Nildram Limited, Trinite Limited, Trinite Services Limited, Pipex Broadband Limited, HighwayOne Limited, Pipex Networks Limited, Pipex Communications Services Limited, GX Networks Twelve Limited, Homecall (UK) Limited and Homecall Payment Services Limited (together, the subsidiaries).

4. The parties filed a complete merger notice with the OFT on 20 July 2007. The OFT's 20 working-day statutory deadline is 17 August 2007.

JURISDICTION

5. As a result of this transaction Tiscali UK and Pipex Broadband and Voice Division will cease to be distinct. The UK turnover of Pipex Broadband and Voice Division exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

FRAME OF REFERENCE

6. The parties overlap in the UK in the supply of:
 - retail broadband internet access services to residential and small business customers
 - retail dial-up ('narrowband') internet access services to residential and small business customers, and
 - fixed-line rental and voice telephony services to residential and small business customers.
7. Recent activity in the supply of internet access and voice telephony services has been characterised by a proliferation of bundled offerings, incorporating up to four services in one bundle, including broadband, fixed-line telephony, television and mobile telephony.² Bundled offerings provide lower costs and a single billing/customer service point, which has led to increased consumer take-up. However, as a majority of customers are still not purchasers of bundled services and research conducted by the Office of Communications (Ofcom) shows that price, is still the most important element to consumers when choosing their internet service provider,³ it is appropriate to consider each of internet access and fixed-line telephony separately.

Product market

Internet

8. Broadband provides 'always-on' access to the internet and internet-based services, allowing both voice and data services to be used simultaneously

² Known as 'double-play', 'triple-play' and 'quadruple-play', describing the number of services within each bundle.

³ Ofcom Broadband – Digital Progress Report, 2 April 2007.

and provides data at higher speeds than a dial-up connection. There are two main retail broadband internet access services available:⁴

- symmetrical access - normally provided via Partial Private Circuits, leased lines or Symmetric Digital Subscriber Line (SDSL) and is distinguished by equally fast upload and download speeds, and
 - asymmetrical - normally provided via Asymmetric Digital Subscriber Line (ADSL) or cable technology and is distinguished by a faster download speed than the upload speed access. Both Tiscali UK and Pipex Broadband and Voice Division's standard retail broadband internet access service is based on ADSL technology.
9. Narrowband refers to internet access at lower speeds than broadband, normally requiring the user to 'dial-up' each time to activate the connection. Both Tiscali UK and Pipex Broadband and Voice Division offer narrowband internet access services.
 10. In previous Ofcom cases, the different delivery infrastructures for internet access (including narrowband, ADSL, wireless and cable) have been considered separately for the purpose of defining the product scope. In particular, narrowband and broadband internet services have been considered separately due to a lack of demand-side substitutability for consumers and weak supply-side substitution.⁵ For similar reasons, Ofcom has also considered symmetric and asymmetric broadband services to be in separate product markets, although it did acknowledge that this may change in the future.
 11. The OFT and the EC have also previously considered narrowband and broadband as separate product markets.⁶ Third parties in this case generally supported that distinction and the OFT has obtained no evidence in this case to depart from that approach. However, it is not necessary to conclude on the precise frame of reference in this case, as it does not materially impact the analysis.
 12. Similarly, in terms of a separation between business and residential customers, although there appears to be little difference between products

⁴ Broadband access can also be provided via other technologies, including wireless and satellite technologies.

⁵ See Investigation by the Director General of Telecommunications into alleged anti-competitive practices by British Telecommunications plc in relation to BTOpenworld's consumer broadband products, 20 November 2003 and Ofcom's Wholesale Broadband Market Access Review 2003/4 published in May 2004 and available at www.ofcom.org.uk/consult/condocs/wbamp/wholesalebroadbandreview/broadbandaccessreview.pdf.

⁶ OFT decision on the anticipated merger of NTL Incorporated and Telewest Global Inc, 30 December 2005; EC decision on Carphone Warehouse/AOL UK Case No. M.4442, 7 December 2006; and OFT decision on the anticipated acquisition by BT Group plc of PlusNet plc, 23 January 2007.

aimed at business and residential customers, concerns do not arise even when examined separately therefore a conclusion on this point is also unnecessary.

Fixed line rental and voice telephony

13. Fixed line rental and voice telephony involve the supply and rental of telephone lines (connecting premises to a telephone exchange) and the associated facility to make and receive telephone calls over fixed (non-mobile) networks. Both Tiscali UK and Pipex Broadband and Voice Division offer a range of retail voice services to both residential and small business customers in the UK.
14. The Competition Commission has previously identified separate product markets for:
 - fixed and mobile line rental
 - retail (encompassing local access) and wholesale services
 - local and (inter)national calls, with further sub-divisions for residential and business customers.⁷
15. For regulatory purposes, the Office of Telecommunications (OfTel), Ofcom's predecessor, previously defined 17 sub-categories of retail calls and lines markets,⁸ including retail residential exchange lines⁹ and retail residential calls.¹⁰ Previous OFT cases have broadly followed the OfTel/Ofcom definitions, though in most cases it has not been necessary to firmly conclude on this point.¹¹
16. In this case, most third parties felt that telephony services provided through both direct and indirect means should be considered together, with no view expressed on any narrower definition.
17. The parties have provided data both on a broad basis (covering all voice telephony customers, separately for residential and business services) and a narrow basis (voice traffic split by type of call - local and national,

⁷ NTL Incorporated and Cable & Wireless Communications Plc: A report on the proposed acquisition, 2000.

⁸ See OfTel Fixed Narrowband Retail Services Market report, 26 August 2003.

⁹ Further separated into (a) residential analogue exchange line services, and (b) residential ISDN2 exchange line services

¹⁰ Further separated into (a) residential local calls, (b) residential national calls, (c) residential calls to mobiles, (d) residential operator-assisted calls, (e) residential IDD category A calls, and (f) residential IDD category B calls (route-by-route basis)

¹¹ OFT decision on the anticipated merger of NTL Incorporated and Telewest Global Inc, 30 December 2005; EC decision on Carphone Warehouse/AOL UK Case No. M.4442, 7 December 2006; and OFT decision on the anticipated acquisition by BT Group plc of PlusNet plc, 23 January 2007.

international and calls to mobiles) therefore this assessment will make use of such data in the analysis.

18. Since concerns do not arise in relation to any of the definitions discussed above, it is unnecessary to conclude on the precise frame of reference in this case.

Geographic market

Internet access services – narrowband and broadband

19. National pricing structures for the provision of internet access services necessitate a national framework for analysis of the geographic scope.
20. Ofcom has previously defined a retail market for internet access across the whole of the UK. Furthermore, the parties submit that both Tiscali and Pipex supply retail internet access products on a UK-wide basis and pursue a national retail pricing policy, in common with other competitors. Lastly, the European Commission has held¹² that the relevant geographic market for internet access (both broadband and narrowband) is national. The OFT has therefore applied a UK-wide frame of reference in this case.

Fixed line rental and voice telephony

21. In its Fixed Narrowband Retail Services Market report,¹³ Oftel defined two distinct geographic markets for fixed exchange lines and calls services: the UK excluding the Hull area, and the Hull area, which reflected the presence of Kingston Communications as the sole supplier in the Hull area.
22. In its latest Wholesale Broadband Review, Ofcom proposed four distinct geographic markets.¹⁴ However, as Ofcom notes, this approach necessarily leads to narrowly-defined markets, as end-users are unlikely to move home to take advantage of lower exchange line rental (or broadband) prices and supply-side substitution requires significant sunk costs.¹⁵
23. Ofcom also considers the use of common pricing constraints to define appropriate geographic markets. At retail level, most internet service providers offer uniform national prices for fixed line rental and voice telephony, which would suggest a UK-wide market – a position supported by third parties consulted in this case.

¹² EC decision on Carphone Warehouse/AOL UK Case No. M.4442, 7 December 2006.

¹³ Oftel report, 2003.

¹⁴ Including: a) Exchanges where Kingston is the only operator (the Hull area); b) Exchanges where BT is the only operator; c) Exchanges where there are two or three operators (including BT and NTL/Telewest) AND exchanges where there are four or more operators (including BT and NTL/Telewest) where the exchanges serve less than 10,000 homes and businesses; and d) Exchanges where there are four or more operators (including BT and NTL/Telewest) where the exchanges serve 10,000 or more homes and businesses.

¹⁵ Wholesale Broadband Access Review (2006), para 4.114

24. The European Commission has also considered the relevant geographic market to cover the whole of the UK, given the increasing importance of the role of national regulation in this sector, the supply of upstream wholesale services on a national basis and that the pricing policies of telecommunications providers are predominantly national.¹⁶ The OFT has also focused on a single UK-wide geographic market in telecommunications in previous cases¹⁷ and has obtained no evidence to warrant departure from that approach in this case.

HORIZONTAL ISSUES

Retail broadband internet access

25. The parties are currently the fourth and sixth largest providers in retail broadband internet access, as set out in Table 1 below. Post-merger, the parties will remain the fourth largest supplier with a combined share of 14.7 per cent.

Table 1: Shares of supply in retail broadband, March 2007

Provider	Share of supply, % (estimated)
BT	26.1
Virgin Media	24.4
Carphone Warehouse	16.1
Tiscali	10.6
Orange	7.8
Pipex	4.1
BSkyB	3.5
Other	7.4

Source: Parties' submission (taken from Enders Analysis)

26. The increase in concentration as a result of the merger is not insubstantial, however, evidence obtained by the OFT suggests that there is significant fragmentation of internet service providers in the 'other' category above.
27. In addition, Ofcom survey data¹⁸ indicates that consumers are well-informed and able to switch suppliers easily, which will help to discipline the merged entity. Research completed by Ofcom suggested that less than

¹⁶ EC decision on Carphone Warehouse/AOL UK Case No. M.4442, 7 December 2006.

¹⁷ OFT decision on the anticipated merger of NTL Incorporated and Telewest Global Inc, 30 December 2005; Completed acquisition of Onetel by the Carphone Warehouse Group plc, 10 May 2006; and OFT decision on the anticipated acquisition by BT Group plc of PlusNet plc, 23 January 2007.

¹⁸ Broadband: Digital Progress Report, April 2007 (Ofcom)

one quarter of consumers were truly inactive, with the rest having at least done some shopping around for alternative providers or packages.¹⁹

28. There has been significant recent growth in customers, with half of all UK adults living in households with a broadband internet connection by the end of 2006.²⁰ There have also been significant declines in broadband prices during the past year, which Ofcom and one third party who commented in this case attribute to growing competition amongst service providers.
29. Overall, recent high levels of entry and exit amongst suppliers (as discussed in the section on barriers to entry below) and strong growth in the number of customers, suggests that the market for the supply of broadband internet access is continuing to evolve. Consumer survey evidence suggests that the majority of customers are well-informed and that switching is not difficult. This has contributed to the falling prices and increasing connection speeds that have prevailed in recent years. Therefore, the OFT believes that no horizontal effects will arise in relation to broadband internet access as a result of the merger.

Retail narrowband internet access

30. In contrast to the growth of broadband in terms of customers and revenue, internet access via narrowband continues to decline due to the falling prices of broadband, by which it has effectively been superseded. By the end of 2006, Ofcom research indicates that only 21 per cent of all residential internet connections were narrowband and half of all current narrowband users said they were likely to convert to broadband within the next 12 months.²¹
31. The parties estimate the total number of narrowband customers to be around four million. Tiscali has approximately [300,000 to 400,000] narrowband customers and Pipex [10,000 to 15,000], which gives the individual parties respective shares of supply of [zero to 10] per cent and [zero to five] per cent. Such a low combined share of supply (with an increment of only [zero to five] per cent) suggests that unilateral effects will not arise in relation to narrowband customers.
32. Neither Tiscali nor Pipex offers business narrowband services.

¹⁹ Ofcom's study of consumer decision making, November 2006 available at: <http://www.ofcom.org.uk/research/tce/report/annex4.pdf>.

²⁰ Broadband: Digital Progress Report, Ofcom (p.2)

²¹ Source: p. 19, Broadband – Digital Progress Report, April 2007 (Ofcom)

Fixed line rental and associated telephony services

33. The total number of fixed exchange lines and fixed voice call volumes²² in the UK has fallen over the past few years, which is having an increasingly downward effect on revenues. Ofcom believes that the recent reduction in voice call revenue can be attributed to price competition, either directly through reductions in individual provider tariffs, or by consumers switching to cheaper packages or providers, with reductions in cost also reflecting underlying technological change.²³
34. The parties' combined post-merger share of supply in fixed line rental and voice telephony is approximately [zero to five] per cent, with a share of supply for residential customers of [zero to five] per cent and for business customers [zero to five] per cent.
35. No third party concerns were raised in relation to these services. Even when examined on the narrowest basis, the parties do not have a share of supply sufficient to warrant concerns over the possibility of unilateral effects arising in relation to fixed-line rental and associated voice telephony services.

Rivalry enhancing benefits

36. Given that neither of the parties are leading suppliers for any of the above-mentioned services, the merger may lead to improved competition with other providers through a strengthening of their own position. Indeed, one third party competitor felt that the acquisition would intensify the already fierce competition present in both internet access and voice telephony services.

Barriers to entry and expansion

37. The parties contend that there are no material barriers to entry due to the availability of wholesale access and a significant amount of recent entry.
38. There have been a number of suppliers that have entered the supply of voice telephony and internet access services, either through acquisition or expansion built on expertise in a related service or product. Recent examples include: Cable & Wireless' disposal of its broadband and voice business (Bulldog) to Pipex in 2006; AOL's disposal of its internet access business to Carphone Warehouse in 2006; Sky's acquisition of EasyNet in

²² Including NTS voice calls: calls to 08xx numbers, premium-rate numbers and directory enquiries.

²³ For example, the introduction of the full carrier pre-selection option at the end of 2001 appears to have precipitated a significant structural shift in the provision of fixed voice services.

2005; BT's acquisition of PlusNet in 2006; Tesco's entry into broadband in 2004 and O2 and Vodafone's entry into broadband in 2006.

39. There has also been a significant increase in local loop unbundling,²⁴ with the number of lines served through local loop unbundling increasing from 0.6 million to 2.6 million between June 2005 and July 2007.²⁵ A number of large suppliers have followed a strategy of developing scale in order to compete effectively by committing investment to this sector, including allegedly loss-leading on certain services (for example, free broadband when bundled with other products or services).
40. Potential concerns about barriers to entry at the wholesale level are mitigated by comprehensive regulatory obligations on BT to provide wholesale access to various relevant network elements under specified conditions. There has recently been entry at this wholesale level through local loop unbundling and BT's obligation to offer Wholesale Line Rental (WLR) and Carrier Pre-Selection (CPS) products has facilitated entry in both voice telephony and internet access services.
41. In summary, the availability of off-the-shelf products – ranging from WLR and CPS to virtual internet service provider solutions – helps to reduce potential barriers to entry. The recent entry of established suppliers from other sectors through bundled multi-play offerings shows that entry is not only possible, but plausible.

Buyer power

42. At the wholesale level, there are a number of customers that can negotiate lower prices due to the high volumes of (either telephone or internet) traffic. Since Pipex is not currently active at the wholesale level, this position is unlikely to change as a result of the merger.
43. Similarly, at the retail level for both internet and telephony services there are some (almost exclusively business) customers that are able to negotiate lower prices due to high traffic volumes. Again, this position is unlikely to be affected by the transaction, since there are still a number of significant suppliers for customers to choose from post-merger.
44. The apparent ease with which even small customers are able to switch supplier also mitigates against any potential concerns.

²⁴ Local loop unbundling is a process by which BT's local loops (from the home to the local exchange) are physically disconnected from BT's network and connected to the network of another supplier. This process enables competing suppliers to bypass BT's wholesale services and exercise a greater degree of control over the provision of a wide variety and differentiation of services, including broadband services.

²⁵ Office of the Telecommunications Adjudicator

VERTICAL ISSUES

45. Pipex does not provide wholesale broadband access to third parties and Tiscali's provision of such services is limited. Nevertheless, both parties self-supply wholesale broadband access (using their local loop unbundling investments) in the provision of their retail broadband services.
46. The parties' combined share of supply amongst local loop unbundling suppliers is around [15 to 25] per cent (increment [zero to five] per cent) and they are the third largest supplier of local loop unbundling. However, there are a number of other wholesale broadband products (such as BT's IPStream and DataStream products) available.
47. One third party suggested that Cable & Wireless may be concerned regarding the wholesale acquisition of Bulldog retail customers.²⁶ The parties submit that the Cable & Wireless wholesale provision to Bulldog retail customers is subject to a five year contract, started in September 2006 and will therefore not automatically be transferred from Cable & Wireless as a result of the merger. If such a transfer were to take place, this could potentially lead to concerns that the merger would undermine Cable & Wireless' local loop unbundling business through the loss of substantial volumes of retail customers from its local loop unbundling exchanges.
48. Whilst it is likely that the parties would have the incentive to acquire these customers – increasing their local loop unbundling customer base and reducing that of a rival (in effect, raising their costs) – the fact that customers are easily able to switch between different internet service providers at the downstream level would hinder their ability to do so. [Endnote 1] Moreover, Cable & Wireless were contacted by the OFT and did not express any concerns in this regard.

THIRD PARTY VIEWS

49. The OFT received only one third party concern in relation to the transaction regarding the possible degradation in customer service they might receive as a Pipex customer being moved over to Tiscali as a result of the merger. However, evidence obtained by the OFT suggests that there are no barriers to switching for customers. Price is currently the most important factor to customers and the recent reduction in retail prices appears to reflect the ability of customers to drive this change.
50. Ofcom were consulted and did not express any competition concerns in relation to the transaction.

²⁶ Pipex acquired the original Bulldog retail customer base when it was sold by C&W and Ofcom understands that C&W is currently responsible for providing wholesale broadband access services for the Bulldog retail customer base using C&W local loop unbundling.

ASSESSMENT

51. The parties overlap in the supply of retail broadband internet access services, narrowband internet access services and fixed-line rental and voice telephony services. The OFT has considered each of these services separately in its analysis, however, as no competition concerns arise on any given frame of reference, it has been unnecessary for the OFT to conclude on the precise product markets in respect of these services.
52. In broadband, the parties are currently the fourth and sixth largest suppliers. The increment resulting from the merger will leave the combined entity as the fourth-largest provider behind BT, Virgin Media and Carphone Warehouse but there is also significant fragmentation of smaller internet service providers. Further concentration in what is already a concentrated market at the top end may give rise to concerns over unilateral effects, however, consumer survey data appears to show that the majority of customers are well-informed and perceive switching between suppliers to be easy.
53. In both narrowband and voice telephony services, the parties have relatively low shares of supply with small increments arising from the merger. Evidence obtained by the OFT suggests switching is feasible and no third party raised concerns regarding either of these services. The OFT therefore believes that no unilateral effects will arise in relation to either narrowband or voice telephony services.
54. Barriers to entry are not particularly high, as evidenced by the amount of entry in recent years. The availability of off-the-shelf wholesale access products (WLR, CPS) has facilitated entry and is likely to continue to do so in the future.
55. Third parties were generally unconcerned with this merger. One third party commented that there may be concerns regarding the wholesale acquisition of particular retail customers. However, the OFT believes that customers are able to switch easily between different internet service providers.
56. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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

ENDNOTES

1. Correction – Tiscali wishes to clarify that Tiscali and Cable & Wireless have agreed, by way of a variation to the September 2006 agreement that the Bulldog retail customers would remain on the Cable & Wireless network.