Anticipated acquisition by BT Group plc of EE Limited

ME/6519-15

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 9 June 2015 (**the Decision**).

Please note that [✄] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

SUMMARY

1. **BT Group plc** (**BT**) has agreed to acquire **EE Limited** (**EE**) (the **Merger**). BT and EE are together referred to as the **Parties**.

2. The Competition and Markets Authority (**CMA**) considers that the Parties will cease to be distinct as a result of the Merger, that the turnover test is met and that accordingly arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

3. The Merger will lead to both horizontal and vertical overlaps between the Parties. BT is the largest provider of fixed-line communications services, including fixed broadband and voice services, in the UK. BT offers these services to end customers on a standalone and bundled basis. BT has recently entered the retail mobile consumer segment. BT is also the largest wholesale provider of a number of fixed services to other communications providers (**CPs**), including mobile backhaul services, which it supplies to mobile network operators (**MNOs**).[1]

4. EE is the largest provider of mobile communications services (consisting of voice, messaging and data services) to retail customers in the UK.[2] It also provides fixed voice, broadband and pay TV services to retail customers in the UK. EE, as an MNO, is the largest provider of wholesale access and call

[1] Based on information provided by the parties and third parties.
[2] Based on information provided by the parties and third parties. See also: Ofcom, *Mobile call termination market review 2015-18*, page 123, Figure 10.

origination services to independent mobile virtual network operators (**MVNOs**), which allow those companies to offer retail mobile services.

5. The CMA issued a preliminary Invitation to Comment (**ITC**) on 4 March 2015 and received extensive submissions from a number of interested third parties. This, together with engagement with Ofcom, has assisted the CMA in its investigation of the Merger.

6. On 15 May 2015, the Parties submitted a request for a fast track reference of the case to a phase 2 investigation and gave their consent to the use of the fast track procedure. The CMA commenced its initial phase 1 investigation on 18 May 2015 and issued a further ITC seeking views on the fast track request.

7. For a case to be fast tracked to phase 2, following such a request, the CMA must have evidence in its possession that it believes objectively justifies a belief that the test for reference to phase 2 is met. As set out in our guidance, fast track cases are likely to be cases where the competition concerns identified impact on the whole or substantially all of the transaction, and not just one part (that could be resolved through structural undertakings in lieu (**UILs**)).[3]

8. The CMA believes that the Merger gives rise to a realistic prospect of a substantial lessening of competition (**SLC**), as a result of vertical effects, in relation to the supply of:

   (a) wholesale access and call origination services to MVNOs in the UK; and

   (b) fibre mobile backhaul services to MNOs in the UK.

9. The CMA notes that the identified SLCs impact on the whole or substantially all of the Merger and not just one part. The CMA has also had regard to its administrative resources and the efficient conduct of the case.[4]

10. In light of the above, the CMA considers that it is appropriate to proceed with a fast track reference of the Merger to phase 2.

11. The CMA also received significant competition concerns in relation to the impact of the Merger on the retail mobile market in the UK. Given that the criteria for a fast track reference are met on the basis of the two issues stated above, it has not been necessary for the CMA at phase 1 to reach a conclusion in relation to other potential competition concerns.

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[3] *Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2)*, paragraph 6.63.
[4] *CMA2*, paragraph 6.65.

12. During the course of the CMA's investigation, third parties raised a number of additional competition concerns regarding the Merger, some of which are referred to in this Decision. Third parties will have an opportunity to fully present their views during the in-depth phase 2 investigation, which is, for the avoidance of doubt, not restricted to investigating the two issues that have been found to give rise to a realistic prospect of an SLC at phase 1.

13. As part of their request for a fast track reference, the Parties waived their procedural rights at phase 1, which included their right to submit UILs. As a result, the CMA has not considered UILs under section 73 of the Enterprise Act 2002 (**the Act**).

14. The CMA therefore referred the Merger pursuant to sections 33(1) and 34ZA(2) of the Act on 9 June 2015.

ASSESSMENT

Parties

15. BT is a UK-based communications services company, active in the provision of fixed-line and mobile communications services, broadband, TV products and services, and managed networked IT services. BT provides, on a wholesale basis, services to MNOs that enable these companies to connect their 'radio base stations' (**base stations**) to their core network. These services are known as 'mobile backhaul services'.

16. BT's group turnover for the year ended 31 March 2015 was £17,851 million.

17. EE is an MNO operating exclusively in the UK, running the EE, Orange and T-Mobile brands. It offers mobile services (consisting of voice, messaging and data services), fixed voice and broadband services and pay TV services to retail customers. EE also provides wholesale access to its mobile network, which allows other companies to offer retail mobile services.

18. EE is a 50:50 joint venture between Orange S.A. (**Orange**) and Deutsche Telekom AG (**DT**), formed by the merger of T-Mobile UK and Orange UK on 1 April 2010.[5] EE has a 50% share in Mobile Broadband Network Limited

[5] The joint venture was notified to, and cleared subject to certain commitments by, the European Commission in case COMP/M.5650 – *T-Mobile/Orange* in 2010.

(**MBNL**), which is a network sharing joint venture with Hutchison 3G UK Limited (**H3G**).[6]

19. EE's total revenue for the year ended 31 December 2013 was £6,482 million in the UK.

Transaction

20. BT, DT and Orange signed a sale and purchase agreement (**SPA**) for BT's acquisition of the entire issued share capital of EE on 5 February 2015. The Merger is conditional upon merger control clearance from the CMA.

21. The purchase price is £12.5 billion. This consideration will be partly satisfied by DT receiving newly-issued ordinary shares in BT, equating to 12% of BT's enlarged issued share capital. DT will also be entitled to appoint one director to the BT board of directors. Orange will receive newly-issued ordinary shares in BT equating to 4% of BT's enlarged issued share capital. Each of DT and Orange will also receive a cash sum for the remainder of the consideration.

Jurisdiction

22. As a result of the Merger, the enterprises of BT and EE will cease to be distinct. The UK turnover of EE exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied.

23. The Merger does not have a Community dimension. The Parties together reach the thresholds set out in Articles 1(2) and 1(3) of the EU Merger Regulation, but fall within the exception for transactions where each of the undertakings concerned have two-thirds of their aggregated Community-wide turnover within one and the same Member State (namely, the UK).

24. The Parties confirmed to the CMA that the Merger is not subject to merger control review in any other jurisdiction.

25. The CMA 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. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 18 May 2015 and the statutory 40 working day deadline for a decision is therefore 14 July 2015.

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[6] MBNL is responsible for consolidating the shared 3G network and other shared site infrastructure of its two shareholders on an ongoing basis. It also acquires certain assets relevant to the shared network, and manages network and operational services in respect of the shared network and unilateral deployments (ie network assets or services specific to either EE or H3G).

26. The Parties submitted that DT and Orange will not acquire ‘material influence’ over BT for the purposes of section 26 of the Act as a result of their proposed shareholdings and (in the case of DT) board appointment, and therefore that these interests do not give rise to one or more relevant merger situations.

27. The CMA received evidence regarding the patterns of attendance and voting at BT shareholder meetings [✂]. The CMA does not consider, based on this evidence, that the acquisition by DT and Orange of these interests (either separately or together) give rise to material influence over BT. Accordingly, they do not give rise to one or more relevant merger situations. These interests are not considered further in this Decision and they do not form part of the reference to phase 2.

Fast track reference

28. On 15 May 2015, the Parties requested that the CMA make a fast track reference of the Merger for an in-depth investigation at phase 2 and gave their consent to use of the fast track procedure.

29. The Parties accepted that the conditions set out in paragraphs 6.61 to 6.65 of the CMA’s guidance on jurisdiction and procedure (**CMA2**) are satisfied and that the CMA will find that the test for reference under section 33 of the Act is met (ie that there is a realistic prospect of an SLC). The request was made without prejudice to the Parties’ overall view that the Merger will not lead to an SLC in any market in the UK.

30. As part of the request, the Parties waived their normal procedural rights during the phase 1 investigation and agreed that the CMA would not be required to undergo all of the procedural steps it normally follows in cases that are referred for a phase 2 investigation.[7]

31. For the CMA to make a fast track reference, it must have evidence in its possession at an early stage of the investigation that it believes objectively justifies a belief that the test for reference is met.[8] In addition, fast track cases are likely to be cases where the competition concerns identified would impact on the whole or substantially all of the transaction, and not just one part (that could be resolved through structural UILs).[9]

32. The CMA has considered the Parties' request and concluded that the available evidence raises a realistic prospect of an SLC in one or more

[7] *CMA2*, paragraphs 6.61, 6.62 and 6.64.
[8] *CMA2*, paragraph 6.62.
[9] *CMA2*, paragraph 6.63.

markets. The CMA notes that the identified SLCs impact on the whole or substantially all of the Merger and not just one part.[10] The CMA has also had regard to its administrative resources and the efficient conduct of the case.[11] In light of these considerations, the CMA decided that it was appropriate to proceed with a fast track reference of the Merger to phase 2.

Counterfactual

33. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers, the CMA at phase 1 generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, when faced with more than one alternative counterfactual, the CMA adopts at phase 1 the most cautious, realistic counterfactual.[12]

34. The CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of the prevailing conditions of competition continuing is not realistic, or where there is a realistic prospect of a counterfactual that is more competitive than the prevailing conditions.[13]

BT's presence in retail mobile services

35. The Parties submitted that, in the period prior to the Merger completing, BT will continue with its plans to launch consumer mobile services through its existing MVNO agreement with EE, and BT Business will also continue to offer mobile services to UK enterprises. The Parties submitted that, absent the Merger, BT would proceed with this organic mobile strategy and that this was therefore the appropriate counterfactual.

36. Taking into account BT's plans to grow in the consumer segment of the retail mobile market, its plans to use innovative 'femtocell' technology, and its likely use of the spectrum it purchased for £202 million in Ofcom's 800MHz/2.6GHz auction in 2013, the CMA believes that the relevant counterfactual is that BT has entered the consumer segment of the retail mobile market and may grow its presence in this market.

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[10] *CMA2*, paragraph 6.63.
[11] *CMA2*, paragraph 6.65.
[12] Which is usually the least favourable position to the parties – see *Nasdaq Stock Market/London Stock Exchange* (January 2007), paragraph 12.
[13] *Merger Assessment Guidelines*, paragraph 4.3.5.

37. However, as the Merger meets the test for reference whether or not BT grows its presence in the retail mobile market, it has not been necessary for the CMA to conclude at phase 1 the extent (if any) of that expansion.

Announced acquisition by Hutchison Whampoa Ltd of Telefónica UK Limited

38. The CMA may be required to consider a merger at a time when there is the prospect of another merger in the same market (**a parallel transaction**).[14] When considering a parallel transaction, the CMA is likely to consider whether the statutory test for reference would be met if the parallel transaction proceeds and also consider whether the statutory test would be met if the parallel transaction does not proceed.[15] If the statutory test for reference is met on either basis, the case should be referred.[16]

39. On 25 March 2015, Hutchison Whampoa Limited, parent company of H3G, entered into an agreement with Telefónica to buy its UK subsidiary, Telefónica UK Limited (**O2**), for £10.25 billion (**the H3G/O2 merger**).[i,ii] The parties have announced the deal and stated that completion of the transaction is subject to EU competition approval.[17] The parties to the H3G/O2 merger operate in a number of the same markets as the Parties.

40. Third parties submitted that the H3G/O2 merger should be taken into account in the counterfactual.[18]

41. The Parties submitted that the H3G/O2 merger is subject to merger control clearance in another jurisdiction and the outcome is highly speculative. The Parties further submitted that to predict such a counterfactual would require the CMA to prejudge the outcome of the European Commission's (the **Commission**) review. The Parties concluded, therefore, that taking a counterfactual with H3G/O2 merged is not realistic and that the correct counterfactual is the continuation of the prevailing conditions of competition absent the H3G/O2 merger.

42. The CMA believes that the H3G/O2 merger is a parallel transaction.[19] It has been signed and announced [✂]. It is not therefore too speculative to be

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[14] *Merger Assessment Guidelines*, footnote 46. The footnote explains that a parallel transaction is considered as part of the counterfactual on the basis that it would occur whether or not the merger takes place.
[15] *Merger Assessment Guidelines*, paragraphs 4.3.5, 4.3.25, 4.3.26 *et seq*. See also *Xchanging/Agencyport Software Europe* (8 December 2014), at paragraph 69 of the Reference Decision.
[16] *Merger Assessment Guidelines*, paragraph 4.3.26.
[17] See Hutchinson Whampoa Limited press release (March 2015): HWL reaches agreement with Telefónica to acquire O2 UK.
[18] Following the CMA's preliminary invitation to comment dated 4 March 2015. See also: *Merger Assessment Guidelines*, paragraph 4.3.26.
[19] *Merger Assessment Guidelines*, paragraphs 4.3.25 to 4.3.26.

considered as a parallel transaction.[20] This is consistent with the Merger Assessment Guidelines and the CMA's previous decisional practice.[21] For example, in *Northgate/Anite*, the Office of Fair Trading (OFT) took into account a parallel transaction, which had completed, but had not received competition clearance from the OFT.[22] Similarly, in *Xchanging/Total Objects*, the CMA at phase 1 took into account a completed parallel acquisition by Xchanging of another group of companies, which was at that time also being considered by the CMA.[23]

43. The fact that H3G/O2 is likely to be investigated by the Commission rather than the CMA (subject to any possible requests under Article 9 of the EU Merger Regulation) does not change this analysis.

44. The CMA recognises that accurately defining the counterfactual by taking into account the H3G/O2 merger poses some challenges, as the Commission's assessment of the H3G/O2 merger could lead to a range of possible outcomes. The Commission could decide on an outright prohibition, an unconditional clearance, or a conditional clearance, with a range of possible remedies.

45. However, the CMA believes that, in light of the OFT and CMA precedent cited above and given the circumstances of this case, the unconditional clearance of the H3G/O2 merger is the most appropriate counterfactual at phase 1. This is the most cautious counterfactual for the purposes of the CMA's competitive assessment of the Merger and is a realistic prospect, recognising that the CMA is not in a position to conduct a competitive assessment of the H3G/O2 merger.[24]

46. Notwithstanding this view, as set out in the competitive assessment below, the CMA's decision on whether to refer the Merger is the same irrespective of whether it applies the counterfactual of the H3G/O2 merger being

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[20] See *Nasdaq Stock Market/London Stock Exchange* (January 2007), *Northgate Information Solutions/Anite Public Sector Holdings Ltd* (October 2008) and *Xchanging Holdings/Total Objects* (December 2014).

[21] *Merger Assessment Guidelines*, paragraphs 4.3.5 and 4.3.25 to 4.3.26: ' … the Authorities, when assessing a merger, cannot ignore a parallel transaction on the grounds it has not been notified to the [OFT], or was notified after the merger under review'. See also *Northgate/Anite* and *Xchanging/Total Objects*.

[22] The CMA notes that under the EU merger regime it is a requirement that the parties do not complete their mergers prior to notification.

[23] *Xchanging/Total Objects* (December 2014).

[24] The CMA recognises that there have been some recent Commission decisions in this sector. See for example, COMP/M.7018 – *Telefonica/E-Plus* (2014), COMP/M.6992 – *Hutchison 3G UK/Telefonica Ireland* (2014), and COMP/M6497 – *Hutchison 3G Austria/Orange Austria* (2012). However, there is uncertainty as to the precedential value of these decisions, which were related to competition in different Member States with different competitive environments.

unconditionally cleared or the prevailing conditions of competition (should H3G and O2 remain separate).[25]

47. Therefore, for the purposes of this Decision, it has been unnecessary for the CMA to conclude on the counterfactual, as the test for reference is met on either basis. The CMA has, where appropriate in its competitive assessment, considered the Merger against the conditions of competition that would exist if H3G and O2 were to merge without remedial conditions and, in the alternative, against the prevailing conditions of competition.[26]

Regulatory framework and Ofcom

48. The telecommunications sector in the UK is subject to substantial regulation, which is overseen by Ofcom. The CMA has worked closely with Ofcom throughout its investigation of the Merger.

49. BT controls the major fixed communications infrastructure network in the UK and provides access to this network through Openreach. Openreach is functionally separate from BT's downstream wholesale and retail activities, in accordance with undertakings offered to Ofcom in 2005 in lieu of a market investigation reference to the Competition Commission (**the Undertakings**).[27]

50. Openreach is required to provide various network access services on an equivalence of inputs (**EOI**) basis. The purpose of these Undertakings is to ensure that other divisions of BT transact with Openreach on the same terms as third party customers and that BT does not discriminate in favour of its own downstream divisions.[28]

51. As part of the investigation, the CMA has sought guidance from Ofcom regarding the operation and effect of the Undertakings and, in particular, how this might change as a result of the Merger. This guidance has been considered where relevant in the competitive assessment.

52. In addition, the UK telecommunications regulatory framework specifies a market review process for the regular review of relevant markets and the

[25] On the assumption that a conditional clearance would fall somewhere in between these two outcomes, in terms of the level of competition in the affected markets, the decision to refer is also the same in that scenario.
[26] For these purposes, the prevailing conditions of competition are assumed to be similar to the conditions of competition were the H3G/O2 merger to be prohibited by the Commission.
[27] During Ofcom's strategic review of the UK telecommunications market, BT offered to Ofcom a set of commitments in the form of Undertakings under the Act, which were in lieu of a reference for an in-depth market investigation by the Competition Commission (one of the predecessors to the CMA). Ofcom accepted the Undertakings on 21 September 2005, and they came into force on 22 September 2005.
[28] The remainder of BT's businesses are run through four other divisions, namely BT Wholesale, BT Business, BT Consumer and BT Global Services. BT also has an internal service unit known as BT Technology, Service & Operations, which supports the customer-facing lines of business.

imposition of appropriate remedies where competition has not yet developed sufficiently.[29] Every three years, Ofcom carries out reviews of those markets recommended by the Commission as suitable for *ex ante* regulation, but also any others that it considers necessary. Where Ofcom analyses a particular market and identifies a provider with significant market power (**SMP**), it must impose appropriate and proportionate remedies.[30]

53. Ofcom has identified a number of markets (including a number of fixed inputs that other CPs require) where BT has SMP and has imposed remedies in a number of cases. As part of its investigation of this case, the CMA has sought guidance from Ofcom on the scope and operation of these remedies. This guidance has been considered where relevant in the CMA's competitive assessment.

Frame of reference

54. The CMA considers that market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.[31]

55. There are a number of important vertical links between the Parties. EE provides BT with wholesale access and call origination mobile services (by virtue of their MVNO arrangement). BT provides mobile backhaul services to EE, as well as to other MNOs (ie Vodafone, H3G and O2). BT also provides a number of other wholesale fixed services that are used both for the provision of retail mobile services and retail fixed services by EE and other MNOs and CPs.[32]

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[29] This is encompassed in the Communications Act 2003 and the Wireless Telegraphy Act 2006, among other statutory provisions, and is underpinned by the European Common Regulatory Framework Directives, which are designed to encourage competition within markets across Europe.
[30] As a minimum, Ofcom will in practice impose an obligation to supply specific services on fair, reasonable, and non-discriminatory (FRAND) terms, and often imposes cost-based CPI-X charge control conditions, breach of which can give rise to administrative penalties and civil actions for damages.
[31] *Merger Assessment Guidelines*, paragraph 5.2.2.
[32] These wholesale fixed services include: wholesale broadband access (**WBA**); wholesale local access; wholesale fixed analogue exchange lines; wholesale ISDN2 and ISDN30 exchange lines; wholesale fixed geographic call termination services; wholesale fixed call origination services; wholesale transit and conveyance services on fixed networks; wholesale end-to-end calls; and wholesale non-geographic numbers services. BT is also active in the supply of other inputs to MNOs and other CPs, including wholesale access to physical infrastructure.

56. The Parties also overlap at a horizontal level in the supply of retail mobile services, retail fixed voice services, retail fixed broadband services, retail pay TV services, retail fixed bundles (incorporating, for example, fixed broadband and pay TV) and retail fixed and mobile bundles.

57. Given the circumstances of this case, the CMA has focused its investigation on whether the test for reference is met in relation to the supply of:

(a) wholesale access and call origination services to MVNOs; and

(b) mobile backhaul services.

58. The CMA has considered the appropriate frame of reference for each of these two areas below. For the purposes of its phase 1 assessment, the CMA has not found it necessary to conclude on the appropriate frame of reference for other areas.

Wholesale access and call origination services to MVNOs

Product scope

59. The four MNOs in the UK (EE, H3G, O2 and Vodafone) currently provide wholesale access and call origination services to MVNOs. This allows companies that do not have their own mobile network infrastructure or hold spectrum to sell retail mobile services.

60. There are over 100 MVNOs active in the UK. Some MVNOs are CPs which offer a range of fixed communications services, such as fixed telephony, fixed broadband and/or pay TV. An MVNO contract allows these companies to offer mobile services on a standalone basis or as part of a bundle of fixed and mobile services. Other MVNOs sell mobile contracts on a standalone basis. These include generalist retailers (such as Asda or Tesco), retailers that target specific ethnic groups (such as Lyca Mobile and Lebara), business-to-business providers (such as Abica) and providers supplying data-only or other niche offerings.

61. The CMA notes that MVNOs can be classified in different ways, either as ‘light’ MVNOs (with little or no infrastructure), ‘full’ MVNOs (which maintain their own core infrastructure and rely on wholesale providers only for access to the radio access network (**RAN**)), or ‘national roamers’ (also referred to as ‘sub-national operators’, which own a RAN and have the ability to provide

some mobile coverage without a MVNO arrangement, but are not able to do so on a national basis).[33]

62. The Parties submitted that there is a single wholesale market for access and call origination on public mobile telephone networks. They submitted that the wholesale mobile access services provided by an MNO are identical irrespective of the customer segment targeted by the downstream MVNO and, therefore, with such strong supply-side substitutability, there is no plausible narrower product market definition.

63. The Commission has previously defined a single market for the provision of wholesale access and call origination on public mobile telephone networks.[34]

64. The evidence before the CMA did not indicate that the product scope is likely to be any wider than the provision of wholesale access and call origination services to MVNOs. The CMA has therefore taken this as its product frame of reference for the purposes of its competitive assessment. On the basis of the conclusions set out in the competitive assessment below, it has not been necessary for the CMA to assess the extent to which the product scope may be narrower in relation to distinct segments of that market.

Geographic scope

65. The Parties submitted that the geographic scope for the provision of wholesale access and call origination services to MVNOs is the UK.

66. The Commission has previously held that the geographic market is national in scope, as the wholesale market corresponds to the dimensions of the MNOs' networks, which are in general limited to national borders owing to regulatory barriers.[35]

67. For these reasons, the CMA considered the impact of the Merger in respect of wholesale access and call origination services to MVNOs in the UK. On the basis of the conclusions of its competitive assessment, it has not been necessary for the CMA to assess the extent to which the geographic scope may be narrower than the UK.

[33] Absent the Merger, this is the model that would have been chosen by BT.
[34] See *Telefonica Deutschland/E-Plus*, paragraphs 75-83, and *T-Mobile/Orange UK*, paragraphs 27-31.
[35] See, for example, *Hutchison 3G Austria/Orange Austria*, paragraphs 74-77.

Mobile backhaul services

Product scope

68. Mobile backhaul is the essential network connectivity that connects an MNO's base station to its core network. The CMA received evidence from third parties that MNOs enter into long-term contractual arrangements for the supply of mobile backhaul services, on a standalone basis, and distinct from other types of leased lines. The CMA received no evidence that, from a demand-side perspective, the provision of mobile backhaul services was substitutable with other types of leased lines other than in relation to different transmission mediums.[36]

69. There are currently three main communication media used for the supply of mobile backhaul, which are copper, microwave and fibre. Of these different media, it is widely considered that fibre backhaul is the most effective, particularly for the provision of 4G backhaul in high-demand areas. This is because it provides very high capacity (ie virtually any bandwidth, depending on the transmission technology, can be used) and has few distance limitations.

70. Third parties told the CMA that, in contrast, other backhaul methods suffer from bandwidth and/or distance limitations and reliability issues. For example, average bandwidth on copper links is provided as multiples of 2Mbit/s, which is not sufficient for standard-cell 4G data requirements. Therefore, as mobile sites are upgraded to 4G, copper-based backhaul links are being replaced with fibre backhaul.

71. Similarly, in relation to microwave backhaul, whilst in peak conditions the potential bandwidth can be high, poor weather results in significant losses (and sometimes complete interruption). This means that microwave sites are planned to achieve less than half of their theoretical throughput.

72. Third parties told the CMA that they considered fibre backhaul to be an essential input for a reliable 4G mobile network and did not consider that other mediums met the necessary requirements for 4G.

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[36] The CMA notes that Ofcom concluded, in its latest Business Connectivity Market Review (**BCMR**) consultation, that backhaul, as supplied to MNOs, should form part of a broader market for wholesale access and backhaul products (see paragraph 1.17). However, the CMA notes that this conclusion is based primarily on supply-side considerations. As set out in the *Merger Assessment Guidelines*, at paragraph 5.2.7, the CMA identifies the relevant product market primarily by reference to demand-side substitutability.

73. The CMA notes that fibre backhaul currently represents around [60–70]% of all mobile backhaul circuits at base stations and has been growing as a proportion of total backhaul year on year.[37]

74. On the basis of this evidence, and particularly given increasing data consumption alongside the widespread adoption of 4G,[38] the CMA notes that there is no effective alternative to fibre backhaul for an increasing number of base stations.

75. The Parties submitted that the supply of 'managed mobile backhaul' services constitutes the narrowest feasible product scope for the purposes of the CMA's review.[39]

76. The Commission has not previously concluded on market definition in relation to the provision of mobile backhaul services.[40]

77. Third parties raised concerns arising from the Merger only in relation to the supply of fibre mobile backhaul services, noting that microwave is largely self-supplied and copper is a legacy technology which is being replaced by fibre.

78. For these reasons, and, in particular, on the basis of a high and growing demand for fibre mobile backhaul services, the CMA has assessed the competitive effects of the Merger using a product frame of reference for the supply of fibre mobile backhaul services to MNOs. On the basis of the conclusions of its competitive assessment, it has not been necessary for the CMA to assess the extent to which the product scope may be even narrower in relation to distinct segments of that market.

79. In its competitive assessment, the CMA has considered the differences in competitive conditions as between the supply of fibre mobile backhaul services by BT Wholesale to MNOs as part of a managed (unregulated) service, and by Openreach to MNOs on an unmanaged (regulated) basis.[41]

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[37] CMA and Ofcom estimates, based on information provided by the Parties and third parties. The CMA also notes that BT supplies managed backhaul services exclusively using fibre mobile backhaul.
[38] For example, see: Ofcom (2015), *Business Connectivity Market Review – Annexes*, paragraphs A11.5 to A11.9, which notes that 4G networks are forecast to cover 98% of the population by 2015.
[39] The Parties note that to date Ofcom has not found that this constitutes a market on its own.
[40] Although different potential segmentations have been considered, for example in Case COMP/M.6584 *Vodafone/Cable & Wireless*.
[41] The CMA also notes that MNOs requiring mobile fibre backhaul can also build or lease unlit fibre (**dark fibre**), if it is available, and install and manage their own electronic equipment. BT is not active in the provision of dark fibre. The CMA has considered the use of dark fibre as compared to 'active' mobile backhaul services (ie those which include both the fibre infrastructure and electronic equipment) where relevant in its competitive assessment.

Geographic scope

80. The Parties submitted that the narrowest feasible candidate market is national in scope, given that contracts for fibre mobile backhaul services are negotiated by a tendering process on the basis of national requirements.

81. The Commission has previously found the market for wholesale leased lines to be national.[42]

82. The CMA has considered the impact of the Merger in respect of the supply of fibre mobile backhaul services in the UK. On the basis of the conclusions of its competitive assessment, it has not been necessary for the CMA to assess the extent to which the geographic scope may be narrower than the UK.

Conclusion on frame of reference

83. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:

(a) The supply of wholesale access and call origination services to MVNOs in the UK.

(b) The supply of fibre mobile backhaul services to MNOs in the UK.

Competitive assessment

Overview

84. Both Parties supply important inputs to CPs, which post-Merger will compete with the merged entity. Therefore, the CMA considered whether the Merger gives rise to a realistic prospect of an SLC as a result of vertical effects.

85. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitor of the supplier's customers. The CMA only regards such foreclosure to be anticompetitive where it results in an SLC in the foreclosed market(s), not merely where it disadvantages one or more competitors.[43]

[42] For example, Case COMP/M.5730 – *Telefonica/Hansenet Telekommunikation*. The CMA also notes that Ofcom, as part of its periodic review, has identified two regional markets within the UK where BT does not have SMP in the supply of mobile backhaul services, namely: (i) the Hull area for all wholesale leased lines; and (ii) the western, eastern and central London area including Slough for medium bandwidth and high bandwidth TISBO lines and for MISBO.

[43] In relation to this theory of harm, 'foreclosure' means either to foreclose a rival or to substantially competitively weaken a rival.

86. In this case, the CMA has identified vertical concerns in relation to the supply of:

(a) wholesale access and call origination services to MVNOs in the UK; and

(b) fibre mobile backhaul services to MNOs in the UK.

87. The CMA's approach to assessing vertical theories of harm is to analyse:

(a) the ability of the merged entity to foreclose competitors;

(b) the incentive of it to do so; and

(c) the overall effect of the strategy on competition.[44]

88. The CMA received significant concerns relating to other areas, including horizontal unilateral effects in the supply of retail mobile services in the UK. Some of these concerns are set out later in this Decision. However, given that the test for reference is met in relation to the two areas above, it was not necessary for the CMA to conclude on whether these additional concerns also met the test for reference.

Input foreclosure in the supply of wholesale access and call origination services to MVNOs

89. The four MNOs operating in the UK (EE, O2, H3G and Vodafone) provide wholesale access and call origination services to MVNOs. EE is currently the largest provider of wholesale mobile services to independent MVNOs.[45]

90. Some MVNOs (such as TalkTalk and Virgin Media) are CPs which offer a range of fixed communications services, such as fixed telephony, fixed broadband and/or pay TV. An MVNO contract allows these companies to offer bundles of one or more fixed communications services together with mobile services (**fixed/mobile bundles**).

91. BT is the largest provider of fixed communications services at the retail level in the UK, both in relation to fixed telephony and fixed broadband.[46] BT offers these services to end customers on a standalone and bundled basis (eg including fixed voice together with fixed broadband and/or pay TV). By acquiring EE, an MNO, the merged entity will combine its substantial market

[44] *Merger Assessment Guidelines*, paragraph 5.6.6.
[45] CMA and Ofcom estimates, based on information provided by the Parties and third parties. This excludes Tesco Mobile, which is 50% owned by O2.
[46] See, for example: Ofcom (2014), The Communications Market Review Report: United Kingdom, Figure 5.35 and Figure 5.39.

shares in fixed communications services together with EE's substantial market share in mobile services.

92. In light of the dependency of MVNOs offering fixed/mobile bundles on MVNO agreements with MNOs, a number of third parties raised concerns that the merged entity might increase the price it charges these MVNOs for access to its mobile network or might refuse to offer access at all to its mobile network. This could leave these MVNOs in a weaker bargaining position with other MNOs when their current contracts expire, which could result in these MVNOs paying higher prices for access to a mobile network. This could reduce the competitiveness of these MVNOs at the retail level.

93. The CMA has assessed, in relation to the supply of wholesale access and call origination services to MVNOs:

   (a) whether the merged entity would have the ability to foreclose MVNOs that compete with the merged entity in the retail supply of fixed/mobile bundles;

   (b) whether the merged entity would have the incentive to do so; and

   (c) the effect of such foreclosure on competition on the retail supply of fixed/mobile bundles.[47]

Ability

94. Absent the merger, EE would continue to be one possible provider available to MVNOs seeking to negotiate a supply contract with an MNO.

95. In the event that the merged entity increased the price it charges for access to its mobile network, or stopped offering access to its mobile network to one or more MVNOs altogether, these MVNOs would then have only three or, in the most conservative counterfactual, two alternative providers of mobile network access (ie H3G/O2 and Vodafone, assuming H3G and O2 merge).

96. The CMA believes that, given the limited alternative providers available, MVNOs would be likely to pay higher prices for wholesale mobile network access against either counterfactual, given that H3G has [✄] a more limited role in the wholesale market compared with other MNOs.[iii]

[47] *Merger Assessment Guidelines*, paragraph 5.6.6.

Incentive and effect

97. The CMA believes that the merged entity would be a stronger provider at the retail level of fixed/mobile bundles as a result of combining BT's position in fixed communications services with EE's mobile services. If the merged entity decided to worsen the commercial terms of access to third parties post-Merger, this could result in higher retail customer diversion from foreclosed MVNOs to the merged entity. The merged entity could also gain a higher retail variable profit margin from customers of fixed/mobile bundles who switch from foreclosed MVNOs.[48]

98. For these reasons, the CMA believes that the merged entity is likely to have the incentive to foreclose MVNOs which are active in the supply of fixed/mobile bundles. This applies to both MVNOs which are current customers of EE (eg Virgin Media) and MVNOs that are future potential customers (eg [✂], and Virgin Media at contract renewal).[49]

99. As the merged entity is likely to have the ability and the incentive to foreclose MVNOs that are active (or seek to be active) in the supply of fixed/mobile bundles, and given that these MVNOs are some of the largest providers of fixed/mobile bundles, the CMA does not believe that the remaining level of retail competition in the provision of such bundles is sufficient to mitigate potential price increases or quality deterioration of retail offers.

Conclusion on input foreclosure in the supply of wholesale access and call origination services to MVNOs

100. Accordingly, the CMA believes that the Merger raises significant competition concerns in relation to the supply of wholesale access and call origination services to MVNOs active in the supply of fixed/mobile bundles in the UK.

Input foreclosure in the supply of fibre mobile backhaul services to MNOs

101. MNOs require mobile backhaul services to connect their base stations to their core network and, specifically, they require fibre mobile backhaul to support their 4G service offerings.

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[48] The CMA understands that, currently, when a broadband customer switches from Sky, TalkTalk or Virgin Media to EE, EE gains the difference between the retail price and the wholesale price EE pays to BT for broadband access. On the other hand, when a broadband customer switches from Sky or TalkTalk to the merged entity, the net incremental margin is the difference between the retail price (minus the cost of provision) and what Sky or TalkTalk are paying to BT for local access. [✂]

[49] EE currently supplies Virgin Media with wholesale mobile services. The MVNO agreement between EE and Virgin Media was signed on [✂] for an initial term of [✂]. The CMA considers that foreclosure could take place either in the context of the current contract between EE and Virgin Media, or at the time of renewal.

102. BT is the ubiquitous provider of fibre mobile backhaul in the UK, supplying approximately [80–90]% of all ethernet-based[50] fibre mobile backhaul (ie including third party suppliers and self-supply).[51] BT supplies fibre mobile backhaul through both Openreach and BT Wholesale.

103. Openreach supplies fibre mobile backhaul services in the form of unmanaged Ethernet Access Direct (**EAD**) products.[52] BT supplies approximately [0–10]% of all its fibre mobile backhaul services through Openreach.[53]

104. BT Wholesale supplies fibre mobile backhaul services either in the form of managed Ethernet Access Connect (**EAC**) products or Managed Ethernet Access Services (**MEAS**). BT Wholesale relies on inputs supplied by Openreach to provide these services. However, managed products include the use of integrated electronic equipment at local exchanges and some additional services such as fault monitoring, repair and connectivity within BT's national transmission network. BT supplies approximately [90–100]% of its fibre mobile backhaul services through BT Wholesale.[54]

105. The CMA notes that Ofcom, in its 2013 BCMR, imposed a number of remedies on BT, in relation to fibre mobile backhaul services supplied by Openreach (including EAD). This included, among other things, requirements that:

   (a) Openreach provides wholesale access to its network for these products to any CP making a reasonable request for access;

   (b) network access must be provided on an EOI basis;

   (c) Openreach must not unduly discriminate against any particular CP; and

   (d) Ofcom would control the level of charges that Openreach can set for its wholesale products.

106. In light of this regulatory environment, the CMA believes that it is unlikely that the merged entity would have the ability to engage in total input foreclosure of mobile backhaul services supplied by Openreach.

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[50] The CMA notes that fibre backhaul supplied to MNOs for the purposes of supporting 4G is ethernet-based, which includes both the fibre infrastructure and electronic equipment. Calculations provided below for the proportion of BT's mobile backhaul products supplied by Openreach and Wholesale relate only to the supply of ethernet-based fibre mobile backhaul products.
[51] CMA and Ofcom estimates, based on information provided by the Parties and third parties.
[52] MNOs purchasing unmanaged fibre mobile backhaul services require other backhaul products to connect different local exchanges to each other, which can be sourced from BT or other providers.
[53] CMA and Ofcom estimates, based on information provided by the Parties and third parties.
[54] CMA and Ofcom estimates, based on information provided by the Parties and third parties.

107. However, third parties raised concerns that the merged entity could still engage in partial input foreclosure in the supply of fibre mobile backhaul services by BT Wholesale to competing MNOs including by:

(a) increasing the price;

(b) reducing the quality;

(c) frustrating innovations which could benefit competing MNOs; and/or

(d) engaging in a margin squeeze strategy by charging retail prices on mobile services that cannot be matched by competing MNOs, given the wholesale prices they have to pay the merged entity.

108. For the purposes of its phase 1 investigation, the CMA has focused its competitive assessment on the possibility of input foreclosure, either under the current contracts or at the time of their renewal, through a price increase or a reduction in quality, of fibre mobile backhaul services supplied by BT Wholesale.[55] On the basis of the conclusions of its competitive assessment, it has not been necessary for the CMA to assess the other possible means of input foreclosure.

109. The CMA has assessed, in relation to the supply of fibre mobile backhaul services currently provided by BT Wholesale, whether:

(a) the merged entity would have the ability to foreclose rival MNOs;

(b) the merged entity would have the incentive to do so; and

(c) foreclosure would result in reduced competition in the retail mobile market.[56]

Ability

110. All four MNOs in the UK purchase BT Wholesale's MEAS product for the majority of their fibre mobile backhaul services and have signed long-term contracts with BT Wholesale.

111. The Parties submitted that the merged entity would not be able to discriminate against competing MNOs in terms of price or quality given that BT Wholesale

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[55] The CMA notes that, of the two fibre mobile backhaul services provided by BT Wholesale, the concerns articulated below are more likely to arise in relation to the MEAS product, given that it includes more managed (and unregulated) additional services compared to EAC (which is largely a retail version of EAD). The CMA notes further concerns which third parties have raised in relation to partial input foreclosure by Openreach at paragraphs 149-152 of this Decision.
[56] *Merger Assessment Guidelines*, paragraph 5.6.6.

relies on inputs supplied by Openreach, which are available on the same terms to others.

112. The CMA notes that Ofcom does not regulate the price or quality of BT Wholesale's managed products and, therefore, there is potentially scope for the merged entity to raise the prices or deteriorate the quality of these services.

113. The CMA also notes that the costs of backhaul services represent a small proportion of an MNO's overall costs.[57] This would suggest that partial foreclosure might be more likely as a result of quality deterioration, or as a result of a combination of quality deterioration and price increases, rather than as a result of price increases alone.

114. The CMA considered whether, at contract renewal, MNOs could switch to alternative providers of fibre mobile backhaul services and so be able to undermine any possible foreclosure strategy.

115. Virgin Media is currently the only large provider of fibre mobile backhaul services other than BT Wholesale, charging prices similar to BT Wholesale and offering a comparable service quality.[iv] Other potential suppliers include Cable & Wireless (owned by Vodafone), TalkTalk, and dark fibre providers such as CityFibre and Zayo.[v]

116. However, the CMA believes that these alternative providers are not sufficiently competitive to undermine any attempt by the merged entity to increase the price and/or reduce the quality of fibre mobile backhaul services because:

(a) Cable & Wireless is not currently active in the wholesale provision of ethernet mobile backhaul services to third parties and may have limited incentive to compete to provide it as this could favour Vodafone's rivals;

(b) TalkTalk is currently not active in the provision of mobile backhaul services, although it provides low bandwidth ethernet connectivity. If it did enter this market, it is unclear at what price it could provide managed backhaul services or whether it would be reliable enough for mobile backhaul applications; and

(c) dark fibre providers cannot reach all the base stations of an MNO, and so cannot offer the same geographical reach as BT Wholesale.

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[57] The Parties submitted that backhaul costs account for a small proportion (less than [0–10]%) of an MNO's total costs. The Parties told the CMA that the majority of these costs reflected [✂].

117. The CMA also assessed whether the merged entity would have the ability to foreclose rival MNOs through a price increase and/or a reduction in quality under the current contracts. The CMA notes that these long-term contracts include significant minimum volume requirements. Therefore, while the long-term nature of the contracts may give an MNO some security in terms of pricing and service continuity, the volume commitments limit that MNO's ability to switch supplier. This means that MNOs could have to accept a deterioration in service quality under the current contracts.

118. One MNO submitted that, given the pace of innovation in the industry, and as demand for mobile data increases, new backhaul technologies will necessarily have to be adopted before the expiry of its contract with BT. It said that this would require the contract to be renegotiated, which could give the merged entity further opportunities to foreclose competing MNOs by offering them unfavourable contractual terms.

119. On the basis of this evidence, and in particular taking into account the current conditions of competition, the CMA believes that the merged entity would have the ability to foreclose rival MNOs as a result of price increases and/or quality deterioration in the fibre mobile backhaul services provided by BT Wholesale both at contract renewal and under MNOs' current contracts.

Incentive and effect

120. The CMA assessed whether the merged entity would have the incentive to foreclose rival MNOs, ie whether its wholesale losses would be compensated by gains at the retail level due to reduced competition from foreclosed MNOs.

121. The CMA notes that a lower quality of fibre backhaul services may have a direct impact on the quality of the retail mobile services that MNOs can provide to their customers. Data provided by Ofcom suggests that poor service is the most important factor driving mobile switching.[58] This would suggest that any material quality deterioration would be a significant stimulus of retail mobile customers switching and, therefore, the profit gains that the merged entity could obtain at the retail level from a foreclosure strategy could be large.

122. The CMA notes that, in contrast, backhaul costs are a relatively small proportion of an MNO's total costs, which suggests that the wholesale profit losses which the merged entity would suffer from a foreclosure strategy could be limited.

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[58] Ofcom (2014), *The Consumer Experience of 2014: Research report*, Figure 162.

123. The CMA therefore believes that the merged entity would be likely to have an incentive to foreclose rival MNOs by increasing the prices and/or deteriorating the quality of the managed backhaul services provided by BT Wholesale.

124. The CMA also believes that, by affecting the competitive offering of other MNOs, in particular by reducing the quality of their services by reducing the quality of the managed backhaul services they receive, this foreclosure strategy is likely to have an effect on competition in the retail mobile market.

Conclusion in relation to the supply of fibre mobile backhaul services to MNOs

125. The CMA believes that BT Wholesale's fibre mobile backhaul services are an important input for competing MNOs and that, post-Merger, the merged entity is likely to have both the ability and incentive to foreclose competing MNOs, at least partially. This could lead to a reduction in competition at the retail mobile market, particularly through a deterioration in the quality of competing MNOs' retail offerings, to the detriment of consumers. The CMA notes that this assessment is the same against either counterfactual (see paragraphs 33 to 47).

126. The CMA notes that, in its recently published BCMR consultation, Ofcom provisionally concluded that it would not expect BT Wholesale to have SMP in relation to the provision of managed mobile backhaul services. Ofcom noted that it 'would expect BT Wholesale's supply […] to be constrained by the prospect of alternative supply using the regulated inputs'.[59] Ofcom also noted that:

> 'in principle, a rival would be able to use Openreach's regulated ethernet leased line services (or dark fibre), together with standard electronic equipment and unregulated transmission links available from BT or its competitors, to supply managed services to MNOs in competition with BT Wholesale (or indeed for the MNOs to self-supply managed services using the same inputs)'.[60]

127. However, the CMA did not receive evidence to suggest that any potential entry would be timely, likely and sufficient to address the foreclosure concerns identified.[61] For the reasons set out above at paragraph 116, the CMA believes that alternative providers to BT Wholesale are not sufficiently competitive to undermine an attempt by the merged entity to increase the

[59] Ofcom (2015), *Business Connectivity Market Review – Annexes*, paragraph A11.69.
[60] Ofcom (2015), *Business Connectivity Market Review – Annexes*, paragraph A11.66.
[61] *Merger Assessment Guidelines*, paragraph 5.8.

price and/or to reduce the quality of its fibre mobile backhaul services to competing MNOs.

128. Several third parties submitted significant concerns about this possibility. They highlighted BT Wholesale's current strong position in the supply of managed mobile backhaul services. They said that this position was a result of BT's cost advantages relative to its rivals, arising from its economies of scale, and the constraints MNOs face in switching away from BT Wholesale due to the existence of long-term contracts with minimum volume commitments.

129. In addition, the CMA notes Ofcom's recognition that BT Wholesale might have some advantages over other potential providers of fibre mobile backhaul services, for example due to its established presence in more of BT's local exchanges than any other CP and its potential ability to exploit economies of scale as a result of its presence in other managed services, such as fixed wholesale broadband access.[62]

130. Accordingly, the CMA believes that the Merger raises significant competition concerns in relation to the supply of fibre mobile backhaul services to MNOs in the UK.

Third party views

131. The CMA contacted customers and competitors of the Parties, and many parties raised concerns about the Merger. Most of these concerns related to the two vertical issues set out in the competitive assessment above. However, the CMA also received concerns relating to a number of additional issues.

132. For the purposes of its decision at phase 1, it has not been necessary for the CMA to conclude on whether these additional concerns result in a realistic prospect of an SLC. However, some of these concerns are listed below.[63]

Retail mobile

133. The Parties overlap at the retail level in the supply of mobile services to consumers and business customers.

[62] Ofcom (2015), *Business Connectivity Market Review – Annexes*, paragraph A11.67.
[63] Third parties will have an opportunity to fully present their views on the Merger during the in-depth phase 2 investigation. The scope of the phase 2 investigation is not restricted to those concerns set out within this Decision.

134. The Parties submitted that EE’s share in this market is approximately [20–30]%.[64]

135. BT is also currently active in this market, operating as an MVNO on EE’s network. BT has for some time been supplying business customers and, in March 2015, it began again to supply directly to consumers. The Parties submitted that BT’s share of supply in retail mobile by subscribers is currently less than [0–10]%. However, the CMA notes that BT had forecasted achieving a share of supply in retail mobile by subscribers of [0–5]% within the first two years of launching its consumer offering, and to reach [5–10]% within five years.

136. The CMA notes that, absent the Merger, BT might have exerted an increasingly significant competitive constraint on rival MNOs and MVNOs. This was particularly the case given its investment in spectrum and innovative femtocell technology, and its substantial customer base for fixed communications services which would provide cross-selling opportunities.

137. Third parties submitted that, due to its spectrum holdings, network assets and backhaul supply, absent the merger, BT would have been able to provide an unmatchable mobile service, for example through faster backhaul upgrades and repairs (benefiting MBNL), larger data bundles and better coverage. On the basis of these advantages, one third party described BT as a prospective ‘super MVNO’.

138. BT provided the CMA with information about its plans to expand in the supply of retail mobile communications services from a full MVNO to a ‘sub-national operator’ through its mass rollout of ‘inside-out’ network (or ‘femtocell’) technology.[65] This would have been possible as a result of BT’s ownership of 4G-ready spectrum (as noted at paragraph 36 above). This would have created a network of small cells in BT customers’ homes, which could have resulted in substantial cost-savings for BT, as BT would have been able to offload some of its mobile data usage from EE’s host network onto the small cell ‘layer’, using directly its own backhaul network.

139. One third party highlighted independent research which suggested that, given the level of mobile traffic consumed in fixed locations (eg in workplaces or customers’ homes), the potential to offload significant proportions of data may be substantial.

[64] The shares of supply data show that EE’s share declined over the period 2012 to 2014, from [30–40]% to [20–30]%.
[65] BT submitted that it intends to continue to develop femtocell technology post-Merger.

140. The CMA notes that the fixed costs required for BT to roll out its femtocell technology, together with any resulting reduction in variable costs (relative to those faced by other MVNOs), would have increased BT's incentives to compete aggressively for customers at the retail level.

141. However, the CMA recognises that, given BT's technological plans were novel, and given that there are many existing MVNO providers, there is some uncertainty about how successful BT would have become in the retail market.

142. The CMA notes that the loss of BT as an independent competitive constraint in the retail mobile market would have been more significant against the counterfactual in which H3G/O2 merge without conditions than in the counterfactual in which H3G/O2 remain separate. In the former case, only two other MNO competitors (H3G/O2 and Vodafone) would remain.

143. Several third parties also told the CMA that some of the other MNOs are likely to face capacity constraints, either now or in the near future. They said that this could have strengthened the competitive constraint which BT may have exerted compared with either counterfactual.

144. Third parties also raised concerns about the impact of the Merger on the current network sharing arrangements, namely Cornerstone Telecoms Infrastructure Limited (**CTIL**) and MBNL.[66],[vi] Some third parties were concerned that improvements to the MBNL shared network could marginalise CTIL. Some said that this could result in O2 switching from CTIL to MBNL following its merger with H3G, which could leave Vodafone marginalised on CTIL and exerting a weaker competitive constraint.

145. The CMA recognises that the loss of BT as a competitive constraint in the supply of retail mobile is a significant issue, particularly against the counterfactual in which H3G and O2 have merged without conditions, where there would remain only three competing MNOs. However, as the test for reference has been met in relation to the two vertical issues discussed above, it has not been necessary for the CMA to conclude on whether or not the Merger results in an SLC in relation to the supply of retail mobile services in the UK.

[66] CTIL is a 50/50 joint venture between Vodafone and Telefónica formed in 2012, with active sharing of 4G infrastructure in London and 2G, 3G and 4G infrastructure in the rest of the UK. MBNL is a 50/50 joint venture between EE and H3G formed in 2007 (between H3G and T-Mobile), with [✂] sharing of 3G and [✂] sharing of [✂] infrastructure.

Retail fixed broadband

146. In order to provide fixed broadband services to their customers, retail operators must connect their core network with the customers' premises. This can be achieved by:

(a) using the provider's own access network (as Virgin Media does);

(b) unbundling BT's local exchanges and using Openreach's inputs for the connection between the local exchanges and the customers' premises, through local loop unbundling (**LLU**) (as Sky and TalkTalk do); or

(c) using BT's wholesale broadband access (**WBA**) products sold by BT Wholesale or by LLU operators (as EE does). WBA products require only a limited number of interconnection points with the retailer's core network to provide nationwide coverage and can be used by new providers entering the market, or by providers wishing to offer services in exchange areas where they have not deployed their own access network or have not unbundled the exchange.

147. In areas where LLU is unprofitable, broadband providers generally rely on WBA products sold by BT Wholesale. Ofcom reviews the WBA market every three years. These reviews led to remedies being imposed on BT in areas where two or less providers were present (either with their own network or as a result of LLU).[67]

148. Third parties raised concerns that the Merger could reduce retail competition in local areas where suppliers rely solely on WBA (ie not LLU). In some of these areas there are very few active retail suppliers. However, as the test for reference has been met in relation to the two vertical issues discussed above, it has not been necessary for the CMA to conclude on whether or not the Merger results in an SLC in relation to the supply of fixed retail broadband services in the UK or any part of the UK.

Other mobile backhaul concerns

149. In addition to the concerns considered in the competitive assessment above in relation to the supply of fibre mobile backhaul services, third parties raised concerns that the merged entity could engage in partial input foreclosure of

[67] These remedies included: *(a)* a requirement to provide network access on reasonable request (including an obligation to provide access on fair and reasonable terms, conditions and charges); *(b)* a requirement not to discriminate; *(c)* transparency obligations; *(d)* a charge control; and *(e)* cost accounting.

other products supplied by Openreach.[68] Specifically, third parties raised concerns that the merged entity might be able to:

(a) discriminate between different MNOs by altering the relative prices of different EAD products. For example, Openreach could differentiate the prices of the various link lengths so as to favour the propagation characteristics of the spectrum owned by the merged entity, while discriminating against new acquirers of higher frequency spectrum;

(b) introduce more costly premium services for enhanced care which rival MNOs may be encouraged to take to overcome delivery and service quality issues, but which would increase their costs;

(c) offer mobile backhaul services more suited to the needs of its mobile division than to other competing MNOs; and/or

(d) block or delay developments in backhaul technology which would otherwise have benefited rival MNOs more than its own mobile division.

150. One third party raised concerns that the merged entity could engage in a margin squeeze strategy by:

(a) reducing its retail prices for mobile services to a level that could not be matched by competing MNOs, in light of the wholesale prices those MNOs would have to pay the merged entity for backhaul services; and/or

(b) deploying more fibre backhaul than a competitor could economically deploy, and in doing so be able to offer its retail customers a quality of service that competitors could not match.

151. Another third party raised a concern that the merged entity could engage in customer foreclosure, as EE might have an incentive to cease purchasing mobile backhaul services from other suppliers and self-supply through BT.

152. However, as the test for reference has been met in relation to the two vertical issues discussed in the Competitive Assessment above, it has not been necessary for the CMA to conclude on whether or not the Merger results in an SLC in relation to any of these other mobile backhaul issues.

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[68] The CMA notes that, under the current regulatory framework, Openreach is obliged to provide other MNOs and CPs with access to its products on an EOI basis and not to discriminate unduly. Openreach is also subject to a charge control. This suggests that the risk of input foreclosure may be lower for these products than for those which are not subject to regulation.

Barriers to entry and expansion

153. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient.[69] The CMA has not received any evidence that entry or expansion would be sufficiently timely or likely to prevent a realistic prospect of an SLC as a result of the Merger.

Conclusion on SLC

154. Based on the evidence set out above, the CMA believes that it is or may be the case that the Merger may be expected to result in an SLC, as a result of vertical effects, in relation to the supply of:

(a) wholesale access and call origination services to MVNOs in the UK; and

(b) fibre mobile backhaul services to MNOs in the UK.

Decision

155. Consequently, the CMA believes that it is or may be the case that the Merger may be expected to result in an SLC within a market or markets in the United Kingdom. The CMA therefore considers that it is under a duty to refer under section 33(1) of the Act.

156. The Parties requested and consented to the use of the fast track process and waived their right to offer UILs. The CMA has therefore referred the Merger pursuant to sections 33(1) and 34ZA(2) of the Act.

Andrea Coscelli
Executive Director of Markets and Mergers
9 June 2015

[69] *Merger Assessment Guidelines*, paragraph 5.8.1.

[i] H3G noted that the agreement was entered into on 25 March 2015, Hong Kong time.

[ii] The price is composed of an initial amount of £9.25 billion and an additional deferred payment of £1 billion to be paid once the cumulative cash flow of the combined company in the UK has reached an agreed threshold.

[iii] H3G noted that it has a *de minimis* presence in in relation to the supply of wholesale access and call origination services to MVNOs [✂].

[iv] This statement is based on information gathered from the parties and certain third parties by the CMA at phase 1.

[v] Vodafone clarified that, as the owner of the Cable and Wireless assets (following their acquisition in 2012), Vodafone is the potential supplier of wholesale ethernet mobile backhaul to third parties. Vodafone currently uses these assets to self-supply mobile backhaul services.

[vi] H3G noted that the network sharing agreement entails [✂].