



SUBMISSION TO THE CMA FROM SSE PLC REGARDING THE PROPOSED MERGER BETWEEN BT AND EE

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Introduction

SSE is a large UK-based energy company with interests in that industry across electricity generation, transmission and distribution; gas transportation; and retail supply of energy products. With respect to the communications markets, SSE has a subsidiary company providing business to business connectivity services using its own UK wide fibre-based core network and in addition, SSE's Retail business provides household customers with fixed line telephone and broadband services using available wholesale products.

SSE believes that there is great potential for innovation in retail communications services from companies that provide services and are thus close to the customer's interests and preferences. A technological development that further increases this potential, in our view, is the convergence of voice and data services towards one underlying currency of data. The origins of BT's ubiquitous access network lie in the monopoly provision of voice services; subsequent technological innovation has allowed the original use of the networks to be optimised for data transmission, with a voice call now able to be treated as data within the wider interconnected electronic communications networks. In order to provide retail customers with electronic communications services, there are three required elements: interconnected networks providing the required connectivity; service provision entailing transmission and manipulation of data; and a customer controlled device to interact with the networks and services. Manipulation of data to create appealing services for users can be undertaken by a wide range of providers and is fertile ground for innovation, as the growth in mobile phone applications or 'apps' has demonstrated.

SSE is concerned that the proposed merger between BT and EE will damage competition in the provision of 'mass market' retail communications services by reducing the number of CPs able to offer competing services and by adversely affecting switching rates. We discuss these areas in turn below, following short descriptions of some relevant characteristics of the fixed line and mobile markets.

Current fixed line market

Ofcom undertook a strategic review of telecommunications in 2004-5 and, in lieu of making a reference to the Competition Commission about features of the market restricting competition at that time, accepted Undertakings from BT which included functional separation of Openreach and the provision of regulated wholesale access to line rental and other wholesale inputs on an 'equivalence of inputs' basis. This meant that BT was required to use the same fundamental wholesale systems and processes at the same price as those available to its downstream competitors for the ordering and delivery of various components supporting existing fixed line retail services. Over time, Ofcom deregulated certain wholesale services (such as wholesale voice calls) as competition became established but key enabling elements for downstream competition remain available from BT on a regulated, non-discriminatory basis.

This has been an important cornerstone for the development of the fixed line market, allowing both vertically integrated CPs and those, like SSE, who do not own relevant infrastructure, to provide services in the fixed line retail market. There are hundreds of service-only CPs and, linking with our views above on the potential for service innovation, SSE believes this brings a strong dynamic of competition and service innovation to the fixed line retail market.

Current mobile market

There is no obligation on mobile network operators (MNOs) to provide wholesale access to any third party and we understand that relatively few commercial arrangements exist between MNOs and other parties for access of this type.

Reduction in competition

If the BT-EE merger proceeds, the combined group will be in a position to offer bundles of fixed line and mobile products at prices that other fixed line CPs will be unable to match. Retail product innovation is likely to follow in the fixed/mobile space where many other CPs will again not have access to the wholesale services necessary to reproduce and build on these developments in their own way. This is because non-discriminatory regulated access to the necessary wholesale inputs is not available for mobile retail services as it is for the main fixed line products, as discussed above.

Thus BT would be in a position to combine EE-based mobile retail infrastructure and services with its ownership of the dominant regulated fixed line infrastructure, while CPs offering fixed line services only would be driven from the market, leading to a less competitive and less innovative retail market in the longer term.

Effect on switching rates

One characteristic of the retail communications market is the development in the last decade of 'bundles' whereby more than one type of service is sold at the same time, often at cheaper rates compared to stand-alone services. A common bundle in recent years has been fixed line phone and broadband services. With the BT-EE merger, we would expect to see that entity promote fixed line and mobile phone service bundles, possibly also including broadband. We now set out how that could lead to reduced switching rates.

Switching processes in the retail communications markets have been subject to review by Ofcom for a number of years now as various types of consumer harm had been identified from the different switching processes that had evolved. Some were 'gaining provider led' (GPL) where the process is controlled by the CP that a customer wishes to move to and some were 'losing provider led' (LPL) whereby the customer had to contact their existing CP to obtain a code in order to be able to switch to another CP. In December 2013, Ofcom required certain types of broadband service switching to change from a LPL to a GPL system, recognising the overall benefits of the latter approach and the difficulties that can be caused for customers and competition with LPL switching processes.

A major concern with LPL processes for SSE, as a relatively small competitor seeking to build market share in retail communications, is the reduction in sales conversion rates compared with GPL processes due to the opportunity for the LP to have a conversation with each customer who intends

to leave and perhaps to persuade them not to. So we have supported Ofcom's work and findings in its switching work to date.

The relevance of bundles to switching rates is that where different processes are used to switch the different elements of the bundle, the 'chilling' effect of an LPL element can affect the whole sale. When broadband switching processes were largely LPL, selling bundles of fixed line phone and broadband would be subject to lower sales conversion rates (similar to those for broadband alone) than sales of fixed line phone only, which works on a GPL basis. Ofcom's 2013 decision should remove this issue for broadband and fixed line phone bundles once fully implemented. However, mobile phone service switching, when the customer wishes to retain their phone number, works on a LPL basis since a 'Porting Authorisation Code' needs to be obtained from a customer's current mobile CP. Thus, if fixed line and mobile phone service bundles were to become widespread in this market, SSE is concerned that they would also be subject to a 'chilling' effect on switching rates as discussed above for phone and broadband bundles.

SSE is in favour of easy-to-use, harmonised, GPL switching arrangements in the communications retail markets, preferably independently governed as an asset for the market as a whole, reflecting the situation with which we are familiar in the retail energy markets. We are concerned that the proposed BT-EE merger will lead to bundled services which contain an LPL switching element that will reduce switching rates and lead again to the sort of problems that Ofcom identified in its work leading to the requirement for a harmonised GPL switching approach for phone and broadband retail services. Lower switching rates adversely affect the competitive dynamics of a market and benefit the first-mover companies able to offer such services – such as the newly merging entity.

Potential Remedies

If the merger between BT and EE is allowed to go ahead, the sort of measures that SSE would like to see to remedy the issues we have raised are:

1. Development of fit-for-purpose regulated mobile wholesale access products and associated services at suitable levels in the hierarchy of system functionality to allow various types of other CP to offer mobile retail services on a non-discriminatory 'equivalence of inputs' basis. We expect that this would allow competition in mobile retail services to thrive and a much wider range of CPs to become involved in innovation of services based on fixed line and mobile phone service bundling.
2. Separation between the retail and infrastructure parts of the merged entity. The functional separation of Openreach volunteered by BT as part of the Undertakings discussed above has been sufficient to allow development of 'equivalence of input' for the main retail services in existence at that time, as required in the Undertakings. However, there is still a lack of transparency in the funding of Openreach and its product development priorities with no regulated access available to the wholesale components of new technical innovations such as fibre broadband technologies. This still allows BT, as the dominant fixed line services provider, to enjoy a continuing 'first mover' advantage as retail services develop.

SSE therefore believes that separation at a deeper level than exists for Openreach within the BT Group is required both for Openreach itself and for separating the infrastructure part of

EE from its retail services operation. In our view, legal separation would provide a clear financial basis for the pricing of the wholesale products discussed above. It would also allow for more transparent wholesale product development in the converging fixed line and mobile retail markets, geared to meet the needs of all wholesale customers of the infrastructure company rather than primarily serving the interests of an in-house retail function.

Conclusion

SSE's main interest in the proposed BT-EE merger is in its potential effects on the 'mass market' retail communications markets where we are already providing fixed line services. We have set out above how we believe that the different availability of regulated wholesale services between fixed line and mobile markets will lead to significant advantages for the BT-EE merged entity with the accompanying inability for many other CPs to provide bundled services on a level playing field, to the detriment of competition and service innovation in the converging markets in the longer term.