

**SKY'S INITIAL SUBMISSION
IN THE PHASE II REVIEW OF BT'S ANTICIPATED ACQUISITION OF EE**

3 JULY 2015

This is Sky's initial submission in response to the CMA's request for third party views as part of the Phase II inquiry into BT's anticipated acquisition of EE (the "Proposed Transaction"). This response supplements and should be read in conjunction with Sky's response to the CMA's Phase I preliminary invitation to comment (the "Sky Phase I Submission") and Sky's response to the CMA's subsequent information request (the "Sky Phase I RFI Response"), provided at Annexes 1 and 2 respectively.

1. EXECUTIVE SUMMARY

- 1.1 The Proposed Transaction gives rise to a substantial lessening of competition in several areas, in particular in the wholesale provision of fixed access, fibre backhaul for mobile network services, wholesale mobile network services for MVNOs and essential inputs for emerging hybrid network services.¹ The scale of the SLCs is significant and their effects pervasive, likely to be felt across the UK telecommunications sector. The Proposed Transaction brings together the UK's incumbent fixed operator and infrastructure owner with the UK's largest mobile operator. BT controls via Openreach the supply of essential wholesale inputs on which downstream competitors rely. EE also controls critical mobile inputs in the form of wholesale access to the UK's largest mobile network underpinned by the UK's largest spectrum-holdings. The merger therefore brings together the control of these critical wholesale inputs. Moreover, it does so just at a time when access to those inputs and the ability to combine them at scale is likely to be crucial to the ability of rivals to compete effectively, both in existing and emerging downstream wholesale and retail communications markets. The merger also exacerbates the competition concerns arising from the erosion of infrastructure-based competition and the significant customer benefits it has delivered to date in retail standard broadband in the transition to superfast broadband ("SFBB"), with increasing strain placed on telecommunications regulation.
- 1.2 As an essential trading partner controlling the critical wholesale inputs necessary for operators to compete downstream, BT has the ability (through its upstream significant market power ("SMP") in the wholesale local access and backhaul services markets) and ample incentive to engage in partial input foreclosure. BT could engage in such foreclosure in a variety of ways including by reducing the quality of inputs, discriminatory service provisioning, fault repair, product development, cost allocation and/or pricing to rivals. EE also controls critical mobile inputs and the merger is likely to reduce its incentives to engage in the supply of wholesale mobile network services.
- 1.3 The existing telecoms regulatory regime cannot address comprehensively the strengthened ability and incentives of the merged entity to foreclose competition in the provision of fixed, mobile and hybrid telecommunications services.
 - 1.3.1 First, operators source a number of key wholesale services from BT Wholesale, rather than sourcing individual inputs directly from Openreach. These managed

¹ The realistic prospect of multiple SLCs arising from the Proposed Transaction is acknowledged by the CMA in its Phase I decision dated 9 June 2015 referring the transaction to a Phase II review (the "Phase I Decision"), both in the narrow grounds identified for the referral (paragraph 8 of the Phase I Decision) as well as the CMA's acknowledgment that multiple potential additional competition concerns could arise (paragraph 11 of the Phase I Decision). The merging parties' acknowledgment of the existence of potential SLCs is also inherent in their request for a fast-track referral of the Proposed Transaction to Phase II, which requires their acceptance that the CMA's statutory test for reference (i.e. that there is a realistic prospect of a SLC) is met.

wholesale services are not regulated and there is limited alternative supply to BT Wholesale. The Proposed Transaction increases the scope for BT to design products that suit the BT Group's downstream operations but not rival communications providers ("CPs") and are sold as unregulated products via BT Wholesale.²

- 1.3.2 Secondly, the regulatory regime is already under major strain in the transition to SFBB and cannot adequately address BT's discriminatory incentives.
- 1.3.3 Thirdly, BT's incentives to foreclose and disadvantage rivals will be made much stronger by the merger and extend into new mobile and hybrid communications markets, which will make it even more difficult for regulation to prevent competitive distortions.
- 1.3.4 Finally, potential future regulatory changes (already in contemplation) are not merger-specific, timely or certain enough to alleviate the significant SLCs created by the merger. Nor can the regulatory regime anticipate and capture every permutation of the merged entity's discriminatory abilities and incentives in an evolving market landscape.
- 1.4 Any claimed efficiencies would need to be merger specific and substantial to outweigh the significant competition concerns. The purported efficiencies already publicised by the merging parties are overwhelmingly non-merger specific and highly unlikely to translate into customer benefits significant enough to outweigh the scale of the SLCs arising.
- 1.5 This initial submission focuses on the key vertical concerns arising from the Proposed Transaction. There are further SLCs which require the CMA's attention, in particular the horizontal loss of rivalry of BT as a super-MVNO in the retail mobile market.³ These are set out in detail in the Sky Phase I Submission and are not repeated here, as the effect on competition of the vertical concerns alone, both individually and cumulatively is substantial. Taken together with the multiple horizontal concerns (which in certain cases reinforce BT's vertical foreclosure abilities and incentives), the Proposed Transaction would have a highly damaging impact on the sector.

2. CONTEXT

- 2.1 The Proposed Transaction risks undermining the significant consumer benefits derived from deep infrastructure-based competition in the fixed telecommunications sector since the establishment of Openreach, pursuant to the BT undertakings in 2005 and Ofcom's regulatory intervention to enable viable local loop unbundling for competing operators, such as Sky.
- 2.2 Contrary to the merging parties' claims that it is consolidation which will be key to delivering consumer benefits in the future, as Ofcom itself has noted in relation to the sector:

"...competition has been good for investment and for consumers...it is better to preserve or promote effective competition between providers, and rely on this to spur investment, rather than deter it. That investment, in turn, leads to better choice and quality for consumers"⁴

² The flexibility associated with supply through BT Wholesale is highlighted in paragraph 112 of the Phase I Decision.

³ Sky notes that the CMA also highlights the significance of this additional competition concern in the Phase I Decision (paragraphs 11 and 145).

⁴ The consumer and citizen at the heart', Speech by Sharon White, Ofcom Chief Executive, at the Which? conference, 11 June 2015: <http://media.ofcom.org.uk/speeches/2015/the-consumer-and-citizen-at-the-heart/>.

- 2.3 Ofcom's intervention to encourage infrastructure-based competition in standard ADSL broadband has enabled scale players such as Sky, TalkTalk, Orange and others to enter the telecoms sector and compete strongly against BT, the incumbent operator. These operators were able to benefit from the economies of scale and scope associated with investing in their own national broadband infrastructure, gain greater control of their cost stack and differentiate their services to the benefit of consumers. Sky has invested over £1 billion in its network, and others have also invested significantly. This competition produced a range of benefits, notably rapid rollout of new broadband technologies, such as ADSL2+, which increased broadband speeds significantly, and innovative new approaches to pricing and packaging (such as 'unlimited' tariffs). The result has been high levels of take-up of broadband services,⁵ falling charges,⁶ and impressive growth in broadband speeds delivered to users.⁷ UK retail broadband prices have been notably lower than those in other EU Member States, delivering consumer benefit.⁸ As discussed further in sections 3 to 8 below, the Proposed Transaction increases BT's market power in a number of existing markets and extends it to new and emerging markets, whilst simultaneously undermining rivals' ability to effectively compete. The merger could therefore lead to BT re-establishing dominance at the retail level and unwind the consumer benefits that have emerged from a decade of infrastructure-based competition.
- 2.4 Furthermore, the Proposed Transaction coincides with a critical juncture in the development of competition in fixed and mobile telecoms in that:
- 2.4.1 Consumers' burgeoning data demands are placing increasing pressure on fixed and mobile players to improve the capacity and coverage of their networks, and as a result wholesale access to critical inputs controlled by BT and EE is even more important;
- 2.4.2 As the market transitions to SFBB, BT has a significant opportunity to exploit anti-competitively its vertical integration. This is because there is both a lighter-touch regulatory regime applying to SFBB and rivals are not able to compete by way of differentiated infrastructure-based competition in the provision of SFBB as they have been for standard broadband. The ability to unbundle local loops for delivering standard broadband was critically dependent on the fact that CPs could install their own equipment in BT's local exchanges. At present, and for the foreseeable future, the situation in relation to SFBB services is very different. The way in which BT has been permitted to roll out SFBB services means that there is currently little prospect of other operators being able to do anything other than re-sell BT's Generic Ethernet Access ("GEA") service in order to supply their customers with a competing broadband service.⁹ This enhanced ability of BT to

⁵ Broadband adoption is at 78% up from 31% in 2005, and LLU accounts for 44% of broadband connections up from 17% in 2005.

⁶ On a like for like basis prices for broadband have fallen significantly since LLU took off. In 2004 the price of 512kbit/s advertised service speed was around £25 per month (Table 2: Residential broadband prices, June 2004 in Ofcom's report 'The Communications Market 2004' August 2004, available at http://stakeholders.ofcom.org.uk/binaries/research/cmr/cm_2004.pdf). Today consumers can get "up to" 76Mbit/s service speed over fibre for the same amount while the price of 16Mbit/s ADSL2+ broadband service is around £10 per month (see Figure 5.9 Comparison of major ISPs' superfast and current generation broadband services, Ofcom's 'The Communications Market Report', August 2015, available at http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr14/2014_UK_CMR.pdf).

⁷ A typical ADSL connection in 2014 offers headline speeds of up to 10Mbit/s compared to 512kbit/s in 2004.

⁸ See, for example, Figures 1.19 and 2.7 of Ofcom's Communications Market Report, International 2014: http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr14/icmr/ICMR_2014.pdf.

⁹ In SFBB, competing operators rely on GEA, an active product from BT, limiting the scope for retail differentiation. Whilst a more upstream passive physical infrastructure access product (which enables access to BT's ducts and poles to enable CPs to lay their own fibre) is available from Openreach, it is characterised by a number of practical limitations that do not enable it to be used by CPs to deploy their own fibre as an effective alternative to GEA at scale.

discriminate in favour of its downstream SFBB operations in turn places increasing strain on the existing regulatory regime. This could assist BT further in re-establishing its historic dominance in the retail broadband market and unwinding the consumer benefits arising from infrastructure-based competition in standard broadband;

- 2.4.3 Convergence in fixed and mobile network services is also expected to gain in significance over the period. This is likely to result in (i) the growing importance of the inclusion of mobile services within a communications and television retail offering and (ii) the development of hybrid network services incorporating both fixed and mobile components and allowing for seamless coverage and improved capacity and quality of service for consumers.
- 2.5 It is important that the CMA's review takes full account of the market developments set out above. What these developments have in common is to place even greater importance on wholesale access to the inputs controlled by the merging parties, as this will be increasingly critical to responding to market changes. It is moreover notable that in this evolution to meet burgeoning consumer demands for data and coverage, operators wishing to remain competitive will need to rely to an ever greater degree on access to BT's high capillary fixed access network, where BT's market power is strongest and competition is weakest.

3. OVERVIEW OF THE MERGED ENTITY'S ABILITY AND INCENTIVES TO UNDERMINE EFFECTIVE COMPETITION

- 3.1 Even individually, the merging parties already have a strong ability to engage in strategies to distort competition in relation to the provision of certain fixed and mobile network services.
- 3.1.1 As the owner of the only ubiquitous national fixed line telecommunications infrastructure in the UK, BT enjoys a significant degree of upstream market power. For the purposes of assessing the impact of the Proposed Transaction, this upstream power in the markets for wholesale local access and backhaul services is particularly relevant. In these areas, BT is an essential trading partner for all competing operators. This confers on BT an inherent ability to foreclose competitors. Although telecommunications regulation is in place to keep this ability in check, BT has increasingly found ways to circumvent its obligations, placing the regulatory regime under increasing strain.
- 3.1.2 As the largest MNO network in the UK with the largest spectrum holdings and the most significant MVNO hosting business in the UK by volume,¹⁰ EE is also an important trading partner for players seeking wholesale MVNO access and could restrict supply options and worsen terms to rivals relying on such access.
- 3.2 The merger will strengthen the existing ability of both BT and EE to engage in anti-competitive manipulation of rivals' costs and quality of service, as the merged entity will combine control of several key upstream infrastructure assets. The merged entity's new combined ownership of both fixed and mobile infrastructure assets will further extend this ability to hybrid and converged network services, which are becoming more important as the market evolves.

¹⁰ EE's position as the largest UK host of MVNOs is acknowledged in paragraph 4 of the CMA's decision on reference in relation to the Proposed Transaction. As of 31 December 2013, EE had 29 MVNO partners, including Asda Mobile and Virgin Mobile. - see EE Annual Report Group and Company Financial Statements for year ended 31 December 2013, available at https://ee.co.uk/content/dam/everything-everywhere/Newsroom/Bonds%20and%20financials/EE_Accts_YE_2013_EY.pdf. This increased in 2014 with the addition of the significant BT MVNO. By the end of 2014, EE reported over 3.7 million MVNO connections on its network: <http://ee.co.uk/our-company/financials/2015/02/05/ee-results-for-the-year-ended-31-december-2014>.

- 3.3 In relation to incentives, BT already earns on average [REDACTED] more per month¹¹ from a retail fixed broadband customer on its network than from a customer served by a third party, such as Sky. This gives BT, even today, powerful incentives to use its upstream market power to undermine the ability of downstream retail competitors to win customers.
- 3.4 Post-merger, BT's incentives to favour its downstream operations will intensify significantly. The effect of the Proposed Transaction is to add to the BT Group a substantial additional downstream consumer business, with revenues over 50% greater than its existing BT Consumer division.¹² Sky anticipates therefore that BT's incentives to favour its enlarged downstream arm will be even stronger. Additional incentives to foreclose competitors will be created in new market areas, such as mobile and hybrid network services. For example, the merged entity is likely to have new incentives to disadvantage MVNO customers (which did not exist when EE was a standalone player), particularly in order to reinforce its quad play differentiation, which is significantly strengthened by the merger.
- 3.5 As a result, BT's market power will be strengthened, both upstream where it will control a much broader portfolio of critical infrastructure assets, and downstream where multiple foreclosure strategies would enable it to establish dominance in existing and emerging retail communications markets. Other operators would be substantially weakened in their ability to compete, ultimately causing long-term customer detriment.
- 3.6 This initial submission focuses specifically on the SLCs arising in the provision of fixed access products, backhaul, wholesale mobile network services and hybrid network services. There are also additional competition concerns, particularly in relation to the loss of horizontal retail mobile competition from BT as a super-MVNO (set out in detail in the Sky Phase I Submission and the Sky Phase I RFI Response).

4. FIXED ACCESS PRODUCTS

- 4.1 There is a real risk that the Proposed Transaction impacts the wholesale supply of fixed access input products that are crucial for the delivery of retail fixed broadband services and are of growing importance to support mobile backhaul. Ofcom has recognised that the next two years are critical in the transition from standard broadband to SFBB.¹³ As SFBB grows in importance, the ability of CPs to offer a credible broadband service (as high speeds become increasingly synonymous with quality) will be critical to remaining competitive going forward. Indeed, all the major fixed operators now offer SFBB.
- 4.2 BT is an essential trading partner for the wholesale inputs necessary to deliver a national retail fixed broadband service, both for standard broadband and SFBB – it is in the wholesale local access market where BT's SMP is strongest and alternatives are least effective. Notwithstanding the regulatory regime which imposes a range of price controls and non-discrimination obligations in wholesale local access markets, this upstream SMP combined with BT's vertical integration provides it with the ability to undermine the effectiveness of downstream retail competitors, primarily through deterioration in service quality, discrimination in product development, cost allocation, provisioning and fault repair and/ or pricing in relation to products which are not price-controlled.

¹¹ Based on Sky estimates

¹² EE's revenue for the year ending 31 December 2014 was approximately £6.3 billion <http://ee.co.uk/our-company/financials/2015/02/05/ee-results-for-the-year-ended-31-december-2014>; BT Consumer's revenue for the year ending 31 March 2014 was just over £4 billion: http://www.btplc.com/Sharesandperformance/Annualreportandreview/pdf/2014_BT_Annual_Report.pdf.

¹³ Paragraph 1.6 of Ofcom's "Fixed access market reviews: Approach to the VULA margin" final statement, dated 19 March 2015: http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/statement/VULA_margin_final_statement.pdf.

4(A) Standard fixed broadband

- 4.3 Already, pre-merger, BT's ability and incentives to undermine downstream fixed standard broadband competitors has manifested itself in: (i) a persistent lack of investment in the BT copper network that underpins delivery of standard broadband services, with resultant service quality issues; and (ii) the prioritisation of product development and design that favours BT's own downstream operations. Such service quality issues discourage switching in the retail standard fixed broadband market, thereby dampening competition. Even if the service quality issues are experienced uniformly by all CPs operating on the Openreach network, this benefits BT disproportionately. This is because, as the incumbent fixed operator with the largest customer base, BT is less dependent on winning new customers from third parties and therefore more likely to retain a strong market position if switching is discouraged. Ultimately, the ability of other CPs to act as an effective competition constraint on BT is diminished.
- 4.4 Sky is concerned that post-merger, BT will have an even greater incentive to neglect investment in its copper network, which has already been subject to historic under-investment¹⁴ and to engage in product development that favours its own downstream operations. With a significant additional mobile infrastructure and consumer business within BT's Group, there will be a greater number of investment projects competing for BT's funding post-merger and therefore a greater risk that funds will not be directed to investment in BT's copper network. This concern does not rely on any form of "capital market imperfection". Rather, BT is aware that investments in GEA, the key wholesale input for SFBB, will increase its competitive advantage, while investments in copper will reduce it. Taking into account the impact on competitors, it is clear that BT can increase its profitability by neglecting investment in the copper network, even though such investments, seen in isolation, may generate a positive return. The gain from reduced competition through neglecting investments in copper can outweigh the positive effect of the return on investment.
- 4.5 The effect of the merger will be to discourage customers from switching broadband providers, thereby increasing the erosion of downstream retail fixed broadband competition.

4(B) Superfast broadband*Pre-merger*

- 4.6 Initially there was no formal price regulation other than a fair and reasonable charges obligation in respect of the essential wholesale input, GEA, but this has now been replaced with the VULA margin test which governs BT's retail SFBB bundles. This test in essence requires BT to maintain a sufficient margin between the retail prices and wholesale costs of its SFBB bundles. Ofcom adopted this lighter-touch approach with a view to striking a balance between promoting BT's incentives to invest and curtailing its ability to exploit its upstream market power to distort downstream competition. In introducing the VULA test, Ofcom had the following concerns:

"It is our view that BT has the incentive and ability to use its SMP in the WLA market to set the VULA margin over the period of the market review such that it causes retail competition in superfast broadband to be distorted."¹⁵ "If this were the case, we consider it could lead to negative outcomes for consumers and competition"¹⁶

¹⁴ See Annex 4 of the Sky Phase I Submission and the response to question 11 (d) in the Sky Phase I RFI Response.

¹⁵ Paragraph 3.61 of the VULA Statement of 19 June 2014. Here, Ofcom considered a range of evidence to inform its analysis: "To date BT has been winning a substantial share of VULA-based retail superfast broadband subscribers, achieving approximately 72% of the new VULA connections supplied by Openreach in Q1 2014. This is despite BT's claim that EE, Sky and TalkTalk are "actively marketing retail fibre services" and its September 2013 view

- 4.7 It is important to note that, even with the test, BT can charge significantly higher wholesale prices, whilst charging only a small price increment over the price of standard broadband at the retail level. The main reason for doing this is that it is profitable for BT at a group level to convert its retail customers to SFBB whereas it is margin dilutive for competing providers to do so. This is because competing providers bear actual costs (the GEA wholesale charges, which are effectively double the relevant wholesale input charges for standard broadband¹⁷) whereas BT Group only bears these in a notional sense (as internal transfer charges) and any incremental retail revenues exceed the relevant incremental costs of providing GEA.
- 4.8 Therefore competing providers do not have the same incentive to upgrade customers to SFBB, whereas upgrading its retail customers is likely to increase BT Group's overall profitability. As a result BT is establishing a far higher share of SFBB than its overall share of the retail broadband market and converting a substantial share of VULA-based retail SFBB subscribers, whilst passing the VULA test.¹⁸
- 4.9 The VULA margin test is also highly complex, and this gives BT ample scope to circumvent it, for example by allocating costs away from those customer groups subject to the test (*i.e.* new customers taking a bundle including SFBB). The ease with which BT can reallocate costs in this way is evident in the fact that, prior to the introduction of the test, BT substantially reduced its bandwidth costs (to which the VULA test is very sensitive), making the test easier to pass. Moreover, the scale – and therefore the impact of these reallocations – can be significant. This is borne out in a recent review of BT's cost attribution methodologies where Ofcom has provisionally concluded that BT's approach to allocating costs between regulated and unregulated products was subject to multiple errors and inappropriate attribution methodologies (amounting to some £262m wrongly allocated to regulated products on which competing providers rely).¹⁹ Even pre-merger, there are significant challenges for Ofcom to adapt the test to changing circumstances.²⁰ The risk of BT re-establishing retail dominance is not abated, albeit that to date Ofcom has sought to strike a balance between this risk and prematurely chilling BT's incentives to invest. BT has of course launched a root and branch appeal of the VULA margin test in the hope of facing lighter regulatory constraints in the near future.

Post-merger

- 4.10 The Proposed Transaction however is transformational: on the one hand it significantly increases the ability and incentives of BT to exploit the regulatory leeway it is afforded in SFBB and circumvent the VULA test, while on the other it renders Ofcom's task of monitoring compliance with it substantially more difficult. The merger therefore increases the risk of BT squeezing margins in SFBB, re-installing a dominant position and foreclosing downstream competition in SFBB and in the fixed broadband retail market more broadly. We explore how in more detail below.

that CPs will "continue to aggressively market fibre-based broadband services". This has resulted in BT currently retailing nearly 80% of all VULA connections." See further paragraphs 3.64-3.70 of the VULA Statement.

¹⁶ Paragraph 3.69 of the VULA Statement.

¹⁷ We set out the applicable charges paid by providers like Sky when converting customers to SFBB at Table 4 of the Phase I Submission.

¹⁸ See further question 5 of the Sky Phase I RFI Response.

¹⁹ Ofcom's Review of BT's cost attribution methodologies of 12 June 2015 at <http://stakeholders.ofcom.org.uk/consultations/cost-attribution-review/>.

²⁰ See Ofcom's consultation on proposed guidance for the treatment of UEFA Champions League rights in the VULA margin test at http://stakeholders.ofcom.org.uk/binaries/consultations/vula-margin-guidance-supplementary/summary/VULA_margin-guidance-supplementary.pdf.

- 4.11 The addition of a significant new consumer business to BT Group increases BT's ability and incentives to exploit the competitive disadvantage faced by CPs in the retail supply of SFBB. The ability to bundle mobile with SFBB increases the scope for BT to charge higher GEA wholesale prices whilst still charging only a small increment for SFBB over standard broadband at the retail level. While BT only notionally bears internal transfer charges, CPs bear increased actual GEA costs. BT's ability to increase its share of SFBB and to convert VULA-based retail SFBB subscribers is enhanced and competition in the retail supply of SFBB is further distorted.
- 4.12 The merger also substantially increases BT's ability and incentives to evade the test by increasing the scope for BT to allocate fixed and common costs to make the test easier to pass. This is likely to manifest itself in BT allocating costs away from new customers taking a bundle including SFBB (to which the test applies) to other groups of customer, notably the proportion of those many new direct mobile customers (some 24.5 million) acquired from EE who do not take BT's SFBB product and therefore to which the test does not apply.
- 4.13 More complex questions also arise as to how to allocate across the substantially enlarged BT Consumer division other lines of cost to which the test is highly sensitive. For example, the inclusion of mobile (when bundled with SFBB) in the test will require detailed consideration. Pre-merger, Ofcom was minded to use the MVNO rates BT secured with EE. Post-merger, Ofcom will be faced with a more complex task of reflecting long run incremental mobile costs (including an allowance for common costs) in the test. In addition to the sensitivities around bandwidth and BT Sport costs mentioned above, the VULA test is also highly sensitive to Selling General and Admin (SG&A) costs, upfront costs of acquiring customers and overheads. The merger increases the complexity and scope for circumvention in the allocation of each of these heads of cost.
- 4.14 It is not clear whether, post-merger, Ofcom would have sufficient visibility across the enlarged BT Group and concurrently across such a wide and expanded range of variables, to properly assess BT's compliance with the test. It will become even more difficult for Ofcom to ensure that the profitability of new customers taking a bundle including SFBB is not simply the product of a reallocation of costs to other customer groups not subject to the test on which BT is making significant losses.
- 4.15 This increased complexity and scope for circumvention brought about by the merger is likely to render the test significantly harder to apply and monitor and ultimately ineffective at constraining leveraging by BT of its upstream SMP. The delicate balance so far struck by Ofcom between safeguarding against this risk and preserving incentives to invest is likely to be undermined. There is an increased risk of margin squeeze in SFBB. There is also the risk that BT will be able to price even more aggressively than it does now to acquire new SFBB customers whilst potentially making substantial losses on other groups of customers not subject to the test. Potentially, these comprise all of BT's existing broadband customers (standard and SFBB), as well as, post-merger, mobile only customers - together a substantial proportion of the retail broadband market that becomes less contestable as a result of the merger. The combination of these effects would have serious consequences for competition in SFBB and in the fixed broadband retail market more broadly (given the importance of SFBB to downstream competition), with likely adverse consequences for consumers (in the form of higher prices, reduced choice and lower levels of innovation).
- 4.16 There is also the potential for the merger to enable BT to leverage the regulatory forbearance it is afforded in SFBB to gain a competitive advantage in related markets such as the mobile retail market. The justification for regulatory forbearance cannot logically be applied to confer on BT additional advantage in mobile retail markets.

5. BACKHAUL SERVICES

- 5.1 The impact of the Proposed Transaction on the provision of backhaul services is complex and damaging, as it affects both the existing fibre mobile backhaul services on which MNOs (and therefore MVNOs) rely in order to provide traditional mobile network services, as well as the developing backhaul services required to support the emerging hybrid fixed-mobile network services, on which a wide array of players may rely going forward. Backhaul for hybrid network services is discussed in section 7 below.
- 5.2 Sky notes that a number of the significant competition concerns arising in relation to the supply of fibre mobile backhaul services to mobile operators are recognised by the CMA in the Phase I Decision.²¹
- 5.3 Absent the merger, in relation to fibre mobile backhaul for traditional mobile network services, BT has the ability to use its upstream market power to extract industry surplus (i.e. to rechannel profits from the mobile operators to itself) from its supply of fibre mobile backhaul, as it is the only ubiquitous provider of fibre mobile backhaul in the UK, with limited alternative suppliers.²² Although the provision of fibre mobile backhaul inputs by Openreach is regulated by Ofcom, this does not curb entirely BT's ability to extract such profits, as all four MNOs have insufficient fixed network coverage of their own to take these inputs and instead currently purchase the downstream Managed Ethernet Access Solution (MEAS), an unregulated managed backhaul product provided by BT Wholesale.²³ In relation to the MEAS product, BT is not under the same regulatory constraints and as such will be able to increase prices, as well as discriminate in relation to product design and service quality.²⁴ However, BT's incentives to target such strategies at particular mobile operators absent the merger would be limited, given that it would have no ownership interest in any specific mobile operator and rather it would be motivated to win the backhaul custom of as many mobile operators as possible, in order to undermine the few competing wholesale backhaul suppliers, such as Virgin Media.
- 5.4 Post-merger, BT's upstream ability to extract an industry surplus transforms into an ability to engage in partial input foreclosure as it vertically integrates with a downstream mobile operator. Question 2 of the Sky Phase I RFI Response sets out Sky's detailed submissions on the merged entity's ability to design bespoke backhaul products that would favour EE at the expense of other MNOs, for example through introducing new product variants that are, in practice best-suited to EE's network architecture, deployment plans and/or customer needs, and by deprioritising product design requested by rival MNOs.
- 5.5 Moreover, as the new owner of the UK's largest MNO post-merger, BT will have significant incentives to engage in a foreclosure strategy that ensures its own downstream mobile division will be differentiated by higher service quality than that of rival MNOs and MVNOs. In this way, BT could reap the benefits of retail mobile customers switching to its services.
- 5.6 The effect of this input foreclosure concern would be to undermine effective retail mobile competition, as both rival MNOs and the MVNOs hosted on their networks would be disadvantaged. This could take the form of reduced service quality, increased wholesale backhaul costs and diminished ability to differentiate from the merged entity, in turn likely to translate into poorer service and higher prices to consumers.²⁵

²¹ Paragraphs 101 to 130.

²² Per paragraph 102 of the Phase I Decision, BT provides 80-90% of all ethernet-based fibre mobile backhaul in the UK. Paragraphs 114 to 116 of the Phase I Decision outline the limitations of alternative backhaul suppliers.

²³ The CMA notes that 90-100% of BT's fibre mobile backhaul supply is through BT Wholesale (paragraph 104, Phase I Decision).

²⁴ This ability to engage in partial foreclosure, notwithstanding existing regulation, is noted by the CMA at paragraph 112 of the Phase I Decision.

²⁵ The effect on retail mobile competition is acknowledged by the CMA in paragraph 124 of the Phase I Decision.

- 5.7 In addition to the input foreclosure concern, a customer foreclosure concern may arise. Absent the merger, EE sources backhaul both from BT and Virgin Media. Alternative backhaul suppliers capable of exerting some competitive constraint on BT have taken a long time to emerge and are dependent on demand from large customers, such as EE, which allows them to build economies of scale and scope in backhaul and adjacent business connectivity markets. Post-merger, EE is likely to shift all of its backhaul demand to BT which BT has both the ability²⁶ and incentive to meet in full.²⁷ As such, the Proposed Transaction is likely to stifle competition in backhaul. Alternative sources of backhaul, such as Virgin Media, are likely to be weakened post-merger by the loss of EE's custom. This will leave them less able to achieve economies of scale in backhaul as well as economies of scope in adjacent markets (such as the provision of leased lines and wholesale networking solutions to corporate customers) which use the same network components. Ultimately, this would undermine effective retail mobile competition as reduced backhaul choice increases costs and reduces service quality for MNOs and in turn MVNOs hosted on their networks.

6. WHOLESALE MOBILE NETWORK SERVICES

- 6.1 There is a clear SLC in relation to the supply of wholesale mobile network services. Indeed, this is one of the fundamental concerns forming the basis of the CMA's referral decision.²⁸ Absent the merger, EE was an important MVNO host and whilst its extensive mobile infrastructure and spectrum holdings would have given it the ability to engage in a partial input foreclosure strategy, its limited position in the supply of retail triple play, quad play and hybrid network services meant that it did not have material incentives to withhold wholesale mobile network services from other providers that could also compete in these areas, such as Sky.
- 6.2 Post-merger, as the largest MNO network with strengthened spectrum holdings, the most extensive 4G coverage and a history of being the most prolific MVNO host, EE would have the ability to engage in partial input foreclosure in wholesale mobile network services. Following the Hutchinson 3G-02 consolidation, MVNOs will have only two other alternative host networks to EE, [REDACTED]. In addition, for the reasons set out in section 5 above, post-merger EE is expected to benefit from favourable access to essential wholesale inputs such as mobile backhaul which would enable it to differentiate its network quality further from that of other MNOs.
- 6.3 Further, the merged entity is likely to have much stronger incentives to engage in a partial input foreclosure strategy than a standalone EE would, particularly in relation to potential MVNO customers that would be able to offer triple-play, quad-play and hybrid network

²⁶ As the largest scale provider of mobile backhaul in the UK, BT will certainly have the ability to meet EE's full demand for backhaul services. In addition, given that Virgin Media won its portion of EE's backhaul demand from BT Wholesale, it is likely that BT Wholesale still has infrastructure links to those EE mobile base-stations, and therefore it would be straightforward for BT Wholesale to recommence backhaul supply to these locations post-merger.

²⁷ BT would have the incentive to grow its own economies of scale in backhaul supply at the same time as weakening the position of competing backhaul suppliers.

²⁸ Paragraphs 8, 100 and 154 of the Phase I Decision.

services in competition with the merged entity. As discussed in further detail in section 5(B)(iv) of the Sky Phase I Submission, a high degree of differentiation between a MNO host and a potential MVNO customer is often a key motivating factor in the decision to grant wholesale access, in order to minimise cannibalisation of the MNO's retail base. By refusing to supply wholesale mobile network services to potential triple play and quad play competitors, such as Sky and TalkTalk, BT would weaken the ability of those players to encourage BT broadband retail customers to switch suppliers. In this way, BT would protect the higher margin it earns from its own retail fixed broadband customers compared to the wholesale margin it earns from operators such as Sky and TalkTalk gaining retail fixed broadband customers. BT's foreclosure incentives would be even more pronounced vis a vis Virgin Media, which does not rely on BT for its primary wholesale inputs. The loss of margin to BT from losing a retail broadband customer to Virgin Media would be even more pronounced without any partially mitigating gain in wholesale revenue.

- 6.4 The overall effect of such a strategy would be weaker competition in the market for wholesale mobile network services, such that MVNOs could face higher wholesale prices, unfavourable non-price wholesale terms and/or reduced service quality, thereby impacting MVNOs' ability to offer high quality, well-priced services to end-customers. These impacts on the retail mobile market were also acknowledged by the CMA at Phase I.²⁹ In addition, poorer access to wholesale mobile network services would also further undermine MVNOs' ability to participate effectively in the provision of hybrid network services and to compete in the provision of quad bundles including mobile services.

7. INPUTS FOR HYBRID NETWORK SERVICES

- 7.1 The SLCs described in relation to wholesale fixed access, fibre backhaul and wholesale mobile network services in Sections 4 to 6 above are of concern individually, but cumulatively they give rise to additional concerns in relation to the emerging area of hybrid network services, which will rely on all of these wholesale inputs. Post-merger, the merged entity's ownership of the largest fixed and mobile networks and spectrum holdings in the UK and its consequent control over the essential wholesale input products that other players require to deliver hybrid network services, would give it an unmatched wholesale and retail position in such services. This will also occur at a critical juncture for the development of these services, given increased capacity and coverage demands on existing fixed and mobile networks.
- 7.2 Hybrid network services are emerging in the UK and are likely to become an important feature of the sector over the period relevant for the CMA's review, as a response to customers' growing connectivity demands. The provision of these services involves using fixed and mobile network assets interchangeably or simultaneously to meet customer demand. This could involve: (i) fixed broadband and MVNO players deploying femtocells (often within the home) in addition to a fixed broadband connection in order to offload mobile traffic onto a fixed connection³⁰ and to supplement the capacity and reliability of the customer's fixed connection through leveraging mobile spectrum³¹; (ii) fixed broadband players establishing new network coverage or enhancing their existing network

²⁹ Paragraphs 96 and 99 of the Phase I Decision.

³⁰ This is a strategy that BT had proposed pre-merger, in order to supplement its wholesale MVNO agreement with EE: BT's CEO, discussing BT's mobile plans at its annual results event in May 2014 stated "*We think we'll be able to get the majority of people's usage onto our network. And where we can't, they'll be able to roam seamlessly onto the arrangement we've got with EE.*", reported in the Daily Telegraph on 5 October 2014: <http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/telecoms/11142047/BT-mobile-network-hit-by-technical-hurdles.html>. See also Annex 2 of the Sky Phase I Submission.

³¹ This is a strategy that has been proposed by Deutsche Telekom, proposed to be a new shareholder in the merged entity and therefore potentially more influential over the merged entity's strategy. Deutsche Telekom's strategy is discussed here: <https://www.telekom.com/vectoring-webinar>.

coverage by using 4G spectrum as a substitute for fixed connections into the customer homes in particular localities³²; (iii) mobile players enhancing their outdoor coverage and capacity using small cells³³. The growing importance of hybrid network services is emphasised in the report assessing claimed merger efficiencies commissioned by BT from Communications Chambers (the "BT Communications Chambers Report").³⁴

- 7.3 Absent the merger, the parties would not have as strong an ability to foreclose rivals in the provision of hybrid network services, as individually they do not have strengths across all of the essential fixed, mobile and structural inputs required for delivering a hybrid network service and even if they sourced inputs from third parties, they would not be able to manage in-house the complex technical handover often required between the fixed and mobile networks. BT would have a strong position in fixed infrastructure but not in mobile, and vice versa for EE.
- 7.4 The merger significantly enhances the parties' ability to foreclose rivals in hybrid network services, as it results in the single ownership of the UK's largest fixed and mobile networks. As such, the merged entity would have the ability to engage in partial input foreclosure as it would have upstream market power in three of the inputs critical for successful deployment of a hybrid network services strategy:
- (a) Backhaul: as noted in Section 5 above, BT is the ubiquitous provider of fibre mobile backhaul. A small cell strategy requires a denser deployment of backhaul links and therefore relies on the fixed access infrastructure where BT's market power is strongest and most enduring i.e. in the high capillarity local access network. This infrastructure advantage will be reinforced as BT launches G.Fast, thereby deploying fibre links closer to the home, which would be even better suited to small cell backhaul. As described in the Questions 3 and 11(b) responses in the Sky Phase I RFI Response, BT could engage in a number of small cell backhaul and G.Fast discriminatory strategies in relation to pricing, product specifications, service quality and rollout prioritisation. The higher capillarity may also currently favour the provision of active rather than passive wholesale products, reducing product differentiation and third parties' ability to provide a competitive constraint downstream.
 - (b) Spectrum: The merged entity will have the largest consolidated spectrum holdings by a significant margin post-merger, holding 260MHz i.e. over 60% more spectrum than either Vodafone, or even a combined Hutchinson 3G-O2. Importantly, it will have the largest contiguous block of 2.6Mhz spectrum, through the combination of BT and EE's existing individual holdings. This spectrum is particularly suited to small cell deployment in light of its propagation characteristics, and the contiguity of the combined spectrum will allow the merged entity to maximise the capacity of its data services.
 - (c) Local exchanges, street cabinets, poles and distribution points: BT's existing network of approximately 5,600 exchanges, 89,000 street cabinets and 4 million distribution points, provides it with a ready-made extensive and economically unmatched national network of outdoor locations for the deployment of small cells with existing backhaul links.

³² This is a strategy that UK Broadband has deployed in central London, under the brand-name 'Relish'.

³³ EE had already started to deploy small cells in rural areas pre-merger. See EE announcement here: <http://community.ee.co.uk/t5/EE-Community-Blog/Connecting-rural-communities-with-micro-networks/ba-p/248477>.

³⁴ See, for example, pages 13-14 of "Benefits for UK citizens and consumers from BT's acquisition of EE" by Rob Kenny of 14 Communications Chambers dated 17 June 2015, available here: <http://www.btplc.com/News/index.cfm#/pressreleases/bt-ee-chief-executive-say-deal-will-create-a-uk-digital-champion-1180519>.

- 7.5 The combination of the above infrastructure dominance would enable the merged entity to gain a critical first-mover advantage in the deployment of small cells. It would also be able to deploy its small cell sites in a non-scalable way, such that competing operators would be foreclosed from optimal small cell sites.³⁵
- 7.6 The provision of the key wholesale inputs required for hybrid network services is not currently regulated in a clear and comprehensive way.
- 7.7 In relation to fibre mobile backhaul, Ofcom's regulatory focus to date has been limited to considering mobile backhaul in the context of macro cells (rather than the small cells or femto cells which are relevant to the provision of hybrid network services), as part of its periodic review of business connectivity markets. The delivery of hybrid network services would require traffic to be backhauled more flexibly from distribution points much closer to the home, for example using BT's local access network. However, there is currently regulatory uncertainty as to whether CPs would have the flexibility to combine Openreach fixed access products with backhaul products to meet their developing backhaul requirements to support investment in hybrid and/or small cell networks.
- 7.8 In addition, BT's market power is strongest in the local access element of the network, with negligible competitive alternatives. Whilst Sky notes that Ofcom has proposed to require BT to provide access to dark fibre which theoretically might address some of the concerns, this remedy will not be available until 2017 at the earliest. This would be too late to prevent the creation of enduring competitive advantages in a fast-moving market. Further, the remedy would take a long time to have any effect and the extent to which MNOs could viably use it is far from certain. The Openreach Mobile Infill Infrastructure Solution product which could be used for small cell site deployment is also an unregulated, non-scalable, product and for the reasons stated in the Sky Phase I Submission, it could be used to favour BT's own downstream small cell deployment. Finally, there is also no regulation of wholesale access to mobile spectrum.
- 7.9 BT claims in the BT Communications Chambers Report that other players could easily replicate the hybrid network services in which the merged entity would have a significant advantage, by sourcing the individual inputs themselves. For all of the reasons above, sourcing from the merged entity would be sub-optimal as competing players would not have equivalent access to the merged entity's own infrastructure. Nor would sourcing individual inputs from other suppliers offer an effective alternative. Pre-merger, BT's own inside-out network strategy was based on sourcing individual inputs from different suppliers, and it was the complexities of making this work coherently, for example, achieving handover between the separate BT and EE networks, that has been reported as causing BT difficulties pre-merger (albeit that BT were still committed to this deployment as part of its super-MVNO entry strategy).³⁶
- 7.10 In this way, the single ownership of the fixed and mobile infrastructure, in itself, would give the merged entity a significant and unmatched advantage over players sourcing inputs from different suppliers, facilitating in-house control of the complicated technical handover process. The BT Communications Chambers Report highlights that:

³⁵ For example, Openreach could design the fibre infrastructure to support a small cell site such that technically only one or two backhaul links can be provided to the site. Alternatively, the small cell site itself could be designed to accommodate only one CP. This is discussed further in the Question 3(a) response in the Sky Phase I RFI Response.

³⁶ See Daily Telegraph article of 5 October 2014: "BT mobile network hit by technical hurdles: Attack on mobile operators could be delayed until next financial year over fears calls will be interrupted in Wi-Fi 'handover'," available at <http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/telecoms/11142047/BT-mobile-network-hit-by-technical-hurdles.html>.

*“BT/EE will be able to use the same mobile core network across macro and femto cells, a simpler technological solution avoiding the need for inter-systems handover”.*³⁷

- 7.11 Given the significant size of BT’s downstream portfolio of companies (including EE) that could benefit from a foreclosure strategy post-merger, BT is likely to have the incentive to engage in such a strategy in relation to hybrid network services. This is particularly the case, as it would gain disproportionate benefits from securing a first-mover advantage in this area. Such a first-mover advantage would not be due to a superior commercial strategy, but instead would build on the ownership of the local access network that is to a large extent not replicable for third party access seekers.
- 7.12 The effect of this foreclosure strategy would be to give the merged entity an unassailable advantage in the development of hybrid network services which are likely to play a key role in the future development of competition. There is a very real risk therefore that the ability of rivals to deploy hybrid network strategies is undermined long term, that BT is able to reinstall retail dominance and that the many consumer benefits from scale infrastructure-based competition in standard fixed broadband delivered to date are unwound.

8. THE COMPLEXITY AND PERVASIVENESS OF THE SLCs

- 8.1 As can be seen from sections 4 to 7 above, the Proposed Transaction raises multiple competition concerns, which individually and cumulatively are likely to have a significant adverse effect on rivals’ ability to compete in the increasingly converging markets for standalone and bundled retail fixed, mobile and hybrid network services. In addition, there are a raft of further competition concerns which are set out in the Sky Phase I Submission and the Sky Phase I RFI Response for the CMA’s consideration, notably the significant loss of future retail mobile competition from the removal of the competitive constraint of BT as a super-MVNO.
- 8.2 The individual SLCs arising from the Proposed Transaction are on a number of levels inter-related which makes them all the more difficult to address. For example, post-merger:
- 8.2.1 the loss of BT as a super-MVNO weakens horizontal retail mobile competition, thereby enabling EE’s retail mobile position to strengthen, that in turn intensifies BT’s incentives to discriminate in favour of its new mobile downstream operations, for example through discrimination in the provision of fibre mobile backhaul;
 - 8.2.2 the individual vertical foreclosure concerns in fixed access, fibre backhaul and wholesale mobile network services could also give rise to horizontal competition concerns as a result of the merged entity’s strengthened downstream position in the retail of triple play and quad play packages and the provision of hybrid network services; and
 - 8.2.3 the horizontal consolidation of BT and EE’s spectrum holdings creates additional horizontal strength for the merged entity in the provision of retail mobile network services (already strengthened by the loss of BT as a super-MVNO) with consequential strengthening of the merged entity’s retail position in the provision of triple play and quad play packages, as well as enhancing the merged entity’s vertical foreclosure abilities in hybrid network services.
- 8.3 Furthermore, the merged entity’s market power across multiple upstream markets and its control of multiple inputs critical to downstream competition means the impact of the SLCs arising from the Proposed Transaction is likely to be pervasive throughout the telecoms sector. All major rivals must source inputs from the merged entity in some capacity. In turn, these inputs are essential (and becoming increasingly important over

³⁷ See page 14 of the BT Communications Chambers Report.

time) to the ability to compete effectively downstream, for example in the provision of triple play or quad play bundles and to cope with increasing demand for data from consumers in and out of the home. BT's claims that any competition concerns in fixed, mobile or hybrid network services would be outweighed by rivals' strengths in adjacent areas, such as Sky's position in retail pay TV provision, are simply not credible.

- 8.4 The impact of the complexity outlined above means that the individual SLCs cannot be assessed, quantified and resolved in isolation. Nor do they relate to individual, severable elements of the merger – as the CMA has acknowledged the SLCs impact on the whole or substantially all of the Proposed Transaction, rather than just one part.³⁸ In addition, in a sector at such a critical stage of evolution, it is crucial to take into account the potential long term adverse effects on competition. In this regard, it is clear that the merged entity would have an unmatched position across the fixed and mobile wholesale inputs critical for existing and emerging competition and as such would be best placed to respond to technology developments and able to establish a dominant position in downstream markets, as they evolve.

9. CLAIMED EFFICIENCIES

- 9.1 Sky notes that, immediately prior to the publication of the CMA's referral decision, which identified a realistic prospect of a SLC arising from the Proposed Transaction, BT preemptively published a report it had commissioned from Communications Chambers focusing exclusively on the purported efficiencies that it claims may arise from the Proposed Transaction.³⁹ Assuming that this report reflects the submissions on efficiencies that the merging parties are making to the CMA in the merger review process (which Sky has not seen), Sky sets out below its observations on the claims made.

- 9.2 As a procedural point, it is important to note that any potential customer benefits raised by the merging parties should only be considered by the CMA at the appropriate time and in the context of the specific SLCs that the merger will create. This is in line with the CMA's own guidance,⁴⁰ which provides that it:

"...will normally take relevant customer benefits into account, as permitted by the Act, once it has decided on the existence of an SLC by considering the extent to which alternative remedies may preserve such benefits".

The CMA must ensure in its assessment of any benefit put forward by the merging parties that the benefit in question:

*"accrues from or is expected to accrue to relevant customers within the UK within a reasonable period from the merger and would be unlikely to accrue without the creation of that situation or a similar lessening of competition."*⁴¹

- 9.3 As such, once the CMA has considered the SLCs arising from the Proposed Transaction, it would be for the merging parties to establish that any claimed efficiencies are both (i) merger-specific and (ii) substantial enough to outweigh the multiple SLCs arising.
- 9.4 Sky considers it to be extremely unlikely that the purported efficiencies would materialise in a manner that outweighs the SLCs arising, for the following reasons:

³⁸ Paragraph 10 of the Phase I Decision.

³⁹ See: <http://www.btplc.com/News/index.cfm#/pressreleases/bt-ee-chief-executive-say-deal-will-create-a-uk-digital-champion-1180519>.

⁴⁰ Paragraph 1.15 of Merger Remedies: Competition Commission Guidelines November 2008 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284415/cc8.pdf.

⁴¹ Section 30(3) of the Enterprise Act 2002.

9.4.1 The vast majority of the claimed efficiencies are not merger-specific:

- (a) Investment to sustain growth: Formal consolidation would not be required to sustain the investments outlined in the BT report. For example, the investments by BT and EE in the deployment of an inside-out network, G.Fast, small cell networks and 5G services were anticipated to occur (and indeed, in some cases, were already occurring) absent the merger.⁴² They are responses to an explosion in the demand for data, and in particular mobile data, which is occurring independent of the merger.
- (b) Innovation: BT claims that a consolidated BT-EE would be more likely to engage in innovation. However, in fact, it appears less likely that a consolidated BT-EE, with an infrastructure owner's mind-set and a significantly enlarged customer base would be as motivated to innovate aggressively. As a standalone challenger in the retail mobile market, entering as a super-MVNO with no existing mobile customer base, BT would have much more of an incentive to innovate in order to win customers from the established MNOs and MVNOs. Industry analysts have echoed the view that, to date, network innovation in mobile markets has been more likely to come from outside the established mobile network owners.⁴³ BT's attempts to foreclose access to local fixed infrastructure also extends to only offering a narrow range of wholesale products that leaves little room for innovation from downstream competitors, as evidenced by the range of wholesale products available for SFBB and (to a lesser extent) standard broadband respectively. The merger is likely to stifle such third party innovation.

9.4.2 The claimed efficiencies are unlikely to benefit customers overall:

- (a) Consolidation to reduce costs: The consolidation anticipated by the Proposed Transaction is transformational for the market landscape, and for all the reasons set out above is likely to significantly undermine rivals' ability to compete. As the history of infrastructure-based LLU competition has demonstrated, effective competition between scale players is more likely to deliver consumer benefits in terms of lower pricing and innovative offerings. Although the merging parties claim that significant cost synergies arise from the Proposed Transaction, there is no guarantee that, even if such synergies are realised, they will be passed on to end-customers. Indeed, BT's retail strategy to date has been overwhelmingly characterised by pricing at the top end of the market for its retail standard fixed broadband products⁴⁴, despite being able to benefit from the economies of scale arising from being the largest fixed network operator in the UK.
- (b) "HetNets" to reduce costs: The claims that the merged entity could use "HetNets" (i.e. hybrid network services) in order to reduce costs, again

⁴² For example, in its May 2014 results presentation, BT discussed details of its "inside-out" network, in particular at slide 35 <http://www.btplc.com/Sharesandperformance/downloads/PDFdownloads/q414-slides.pdf>. EE had announced investments in 5G research in 2013: <http://www.telegraph.co.uk/technology/mobile-phones/10836838/EE-plans-5G-network-by-2022.html> and earlier this year announced a 3 year network investment plan which would support the development of 5G services: <http://ee.co.uk/our-company/newsroom/2015/02/11/ee-commits-to-new-network-investment-plan>.

⁴³ See Analysys Mason report on the Proposed Transaction and the merging parties' efficiency claims: <http://www.analysysmason.com/BT-EE-acquisition-UK-Jun2015-RDTW0-RDTN0/>.

⁴⁴ Although Sky notes BT's lower-priced Plusnet standard broadband brand, this is not sold at the scale of BT's mainstream offering.

seem less likely to accrue to end-customers post-merger. Pre-merger, BT's inside-out network offload strategy would have offered an immediate saving in the variable costs payable to its MNO host, EE, and as such may have been translated into retail price reductions (particularly where BT was seeking to enter and build scale in the retail mobile market as a challenger MVNO). However, post-merger, any inside-out network deployed by the merged entity is more likely to be used for the purpose of supplementing upstream capacity, thereby generating capex savings, which may have a less direct translation into improved retail pricing.

- (c) Ability to address rapid industry change and uncertainty: It is precisely because the sector is at a critical juncture of rapid technological change that the ability of a broad range of market players to obtain competitively priced, good quality access to the fixed and mobile inputs necessary to compete in the evolving market landscape should not be undermined by allowing the consolidation of the two largest fixed and mobile infrastructure-owners into one vertically integrated group, with strong incentives to favour its own downstream operations.
- (d) Creation of a national champion similar to fixed-mobile incumbents in other EU Member States: BT claims that the Proposed Transaction would create a fixed-mobile incumbent that would be similar to those established elsewhere in the EU and notes that the lack of such a consolidated player in the UK has been an unusual feature of the UK market. Sky would argue that it is this unusual position, the resultant diversity of market players and the effective downstream competition in the sector that has enabled the UK to have one of the lowest priced/ most innovative telecommunications sectors in Europe.

10. THE INABILITY OF REGULATION TO ADDRESS THE SLC

10.1 Where SLCs have been identified as arising from a merger and these are not outweighed by claimed efficiencies, the CMA is required to identify remedial action which achieves a swift and comprehensive solution to the SLCs and their effects, in a manner which is capable of effective implementation, monitoring and enforcement.⁴⁵ A reliance upon existing or future contemplated telecoms regulation, to resolve the significant SLCs arising from the merger would fail to meet the effectiveness criteria set out in the CMA's own guidelines⁴⁶:

- (a) Impact on SLC and resulting adverse effects: The CMA's guidance emphasises the importance of restoring the process of rivalry lost in a merger scenario through remedies that re-establish the structure of the market, preferably through structural measures such as prohibition.⁴⁷ Resorting to behavioural regulation will not provide a structural solution and will therefore fail to address the adverse effects of the merger directly and comprehensively at source by restoring rivalry. In addition, the ability to regulate effectively is in itself undermined by the merger.
- (b) Appropriate duration and timing: The CMA's guidance outlines a preference for remedies that act quickly in addressing competitive concerns. A reliance on future regulatory intervention would not be a timely solution to the SLC. The outcomes of Ofcom's periodic market reviews lie too far in the future and not even within the relevant market review period (for example, the current Business Connectivity

⁴⁵ Paragraphs 1.7 and 1.8 of Merger Remedies: Competition Commission Guidelines November 2008 (the "Merger Remedies Guideline": https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284415/cc8.pdf).

⁴⁶ Paragraph 1.8(a-d) of the Merger Remedies Guidelines.

⁴⁷ Paragraph 2.14 of the Merger Remedies Guidelines.

Market Review could deliver a form of access to dark fibre from 2017 but the impact of this new policy may not be noticeable until many years after) and are too uncertain (given that they may be subject to multiple appeals) in order to address the SLC in a timely manner. Further, a reliance on non-discrimination obligations in SMP regulation in order to contain the merged entities' incentives will only bite in relation to Openreach activity in regulated markets and will require aggrieved parties to bring time-consuming and resource intensive regulatory disputes, which is inconsistent with timely mitigation of the SLCs within commercially meaningful timeframes.

- (c) Practicality: The guidance provides that *"a practical remedy should be capable of effective implementation, monitoring and enforcement"*. It would be highly impractical to rely on regulation (existing or augmented) that requires ongoing monitoring to deal with the complexity and scale of the SLCs created by this merger.⁴⁸
- (d) Acceptable risk profile: The CMA should seek remedies that have a high degree of certainty of achieving their intended effect. The existing regulation in this sector is extremely complex and, in certain cases, will be made more complex by the merger. The markets involved are dynamic and subject to frequent technological change. In such circumstances any remedy which relies on regulatory intervention will not be sufficiently certain to address the SLCs arising.

11. CONCLUSION

- 11.1 The confluence of the multiple, inter-related SLCs outlined above (and in Sky's earlier submissions) and their pervasive effects likely to be felt throughout the telecoms sector, makes it all the more difficult to address the concerns raised by the Proposed Transaction in a comprehensive, clear-cut and timely manner.

Sky

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⁴⁸ The CMA's preference for structural measures over complex behavioural access measures is noted at paragraph 2.20 of the Merger Remedies Guidelines.