

## ANTICIPATED ACQUISITION BY BT GROUP PLC OF EE LIMITED

### Summary of hearing with TalkTalk on 28 July 2015

#### Overview of TalkTalk's concerns

1. TalkTalk told us that it was most concerned with the impact of the merger on access to wholesale mobile services (ie those required by Mobile Virtual Network Operators, or 'MVNOs'); in particular, that businesses with fixed network offerings would be foreclosed from the mobile market. TalkTalk said that it was a potential customer of the merged entity.
2. TalkTalk said that the wholesale market did not work very well at present, but the merger would make matters even worse because the combined entity would have no incentive to offer competitive terms to competing providers of fixed communications services (including those who were driving down the price of quad-play products).
3. TalkTalk said that its dealings with BT Group in other wholesale markets had not been good. [✂]
4. TalkTalk said that the consumer market was moving towards quad-play, and this was happening quickly. By way of example, in the last two and a quarter years, TalkTalk had increased the number of its broadband customers purchasing TV to 37% and purchasing mobile to 14%.
5. TalkTalk also considered that the merger would lead to a reduction in competition in the retail mobile market, in particular the consumer segment. Absent the merger, BT would have been an aggressive player. Following the announcement of the merger, [✂].
6. TalkTalk was also concerned with the impact of the merger on access to backhaul services (required by Mobile Network Operators, or 'MNOs' that used these fixed services to link their base stations with their core networks). TalkTalk said that it was neither a customer or potential supplier in this market, but was concerned based on its experience of being a customer of BT Group in relation to the supply of various inputs.
7. TalkTalk was also concerned that the merger would lead to the elimination of competition in the supply of broadband in an area defined by Ofcom as

'Market A1'<sup>1</sup> and/or rural areas. TalkTalk said that it had withdrawn from this market due to [REDACTED]. TalkTalk considered that the only scale competitors were BT, BT Plusnet and EE, and that Plusnet already charged a premium. TalkTalk considered that the removal of EE would be extremely bad for remaining consumers.

8. TalkTalk said that 30 years after BT's privatisation, the merger created a group which was as strong as it was then, with all of the copper network and 47% of spectrum.

## General trends

9. TalkTalk said that the extent to which the technology underpinning fixed and mobile networks was converging (eg femtocells), and how that was driving innovation, was relevant to the CMA's inquiry. TalkTalk said that, for example, the nature of 4G LTE/IP network technology was making it easier to integrate and this would give the merged entity a significant technological advantage. TalkTalk also noted that consumers were not interested in which network they were on, but rather were much more interested in which app they were using.
10. TalkTalk said that, as technology had converged, so had consumer propositions. Bundles could offer customers a much better deal, and the move to quad-play, while happening fast, was nascent. TalkTalk said that it was generally less at the forefront of these trends; for example, TalkTalk was late in bundling TV compared with players like BT, Sky or Virgin Media.
11. TalkTalk said that there were some benefits to bundling, such as the offer to its customers of free phone calls home from TalkTalk mobiles when calling a TalkTalk landline. [REDACTED]

## BT's entry into retail mobile

12. TalkTalk said that it had expected BT's entry into mobile [REDACTED]. TalkTalk referred to various quotes by BT regarding its plans to roll out a cheap internal 4G network, combined with BT's fibre broadband, to offer cheaper data offload in customers' homes. TalkTalk noted BT's ambitions to offer a seamless, converged proposition. TalkTalk said that, in contrast, it considered [REDACTED] consumers would ultimately not have as low prices as they would have in a world without the merger.

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<sup>1</sup> Market A was defined as those areas of the UK where BT was the only unbundled provider of broadband services and/or where no more than one alternative provider to BT had also unbundled.

13. [REDACTED] TalkTalk said that BT was very strong in the small business market, with a 60 to 70% share<sup>2</sup> in SME broadband.
14. [REDACTED] TalkTalk said that Plusnet would charge more than TalkTalk, but less in a bundle than Sky and Virgin would. Plusnet focused on the quality of the product (eg the router/Wi-Fi) and had regular contact with its fixed line customers.
15. TalkTalk had launched an 'all-in-SIM' in April/May 2015 [REDACTED]. TalkTalk contrasted this with the eventual minimal spend by BT with the approximately £3 million a week BT spent on advertising BT Sport. TalkTalk said that BT had not mentioned in publicity the use of an inside/out network.
16. TalkTalk believed in using small cell offload to defray the costs of an MVNO and considered that this could significantly reduce reliance on wholesale data charges. Small cell offload also had a quality advantage for the consumer in the home, given that 40 to 50% of calls were made in the home but reception could be poor. This meant that there was both a cost saving and a benefit to customers.
17. [REDACTED].
18. TalkTalk said that there was already an overlap between BT and EE's customers as BT provided wholesale services to EE for its broadband business. [REDACTED] BT's broadband business was very important to EE.
19. TalkTalk said that the spectrum that BT held also gave it an advantage in femtocell deployment. TalkTalk said that that particular spectrum (2.6GHz) was valuable because it was standardised and was used by all handsets. It was also a wide band (15MHz of FDD spectrum), which made it best for small cells. TalkTalk said that the use of this type of dedicated spectrum was better than any other options.
20. TalkTalk said that it acquired access to 1800MHz 'guard band' spectrum in 2006. TalkTalk said that both the 1800Mhz and 2.6Ghz spectrum bands were well supported and were ideal for femtocells. TalkTalk said that BT had 15Mhz of 2.6Ghz, compared to TalkTalk's holding of 3Mhz. In addition, BT's spectrum was dedicated, whereas TalkTalk's was shared among 12 licensees. Therefore, [REDACTED]. TalkTalk said that BT [REDACTED] took a big risk buying £200 million of spectrum. [REDACTED]. TalkTalk said that, while it was correct that the smaller the cell area, the less bandwidth was needed, there would be an

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<sup>2</sup> TalkTalk subsequently revised this figure to 50%.

impact on performance the more concurrent users there were. For example, [REDACTED].

21. TalkTalk said that the code of practice for guard band embodied some basic principles but had not been updated for some time, and still reflected 2G technology. TalkTalk said that it did encourage investment and a first mover advantage by providing a level of protection to those that deployed in a given area. It was an open licence and could be used for 4G. TalkTalk said that this could be done without licence variation, but [REDACTED].
22. TalkTalk said that the use of a femtocell unit could transform call quality, including in areas with poor mobile reception. It was possible to deliver better voice experience in the home while reducing offload costs significantly by doing so. TalkTalk said that a common complaint of consumers was that Wi-Fi did not work in the garden. TalkTalk said that Wi-Fi was already quite congested so, with extended range, femtocells could improve service when Wi-Fi was congested.
23. TalkTalk said that the faster you could put the traffic onto backhaul, the lower your overall costs would be. TalkTalk said that BT had many points of presence where it could put its small cells. TalkTalk said that this could release huge scale economies. In addition, moving from 1Gb/s backhaul to 10Gb/s with dark fibre could exponentially reduce costs.
24. [REDACTED]

## **Quad-play and bundling**

25. TalkTalk said that the UK was behind other countries on the trend towards quad-play (ie fixed/mobile bundles). TalkTalk said that this could have been as a result of BT's decision to sell Cellnet, which meant that the fixed incumbent in the UK did not have a mobile presence. TalkTalk said that this may have been more of an accident of history than anything intrinsic in UK consumer preference. TalkTalk said that the UK had been much slower to build triple play (ie broadband, voice and TV) compared to France. TalkTalk said that the power in terms of the technology alignment, the ease with which you could scale mobile, relative to the complexity of TV content, meant that [REDACTED].
26. TalkTalk said that quad-play customers had [REDACTED]. TalkTalk said that [REDACTED] higher customer satisfaction took away a significant chunk of costs because customers called less with problems. [REDACTED] TalkTalk said that all telecoms businesses were on an endless quest to reduce churn.

27. TalkTalk said that all research indicated that the more ‘touch points’ a company had with its consumers, the more loyalty customers would have for that brand. TalkTalk said that mobile was an important additional service to offer customers. Less went wrong with mobile compared to TV and [REDACTED].
28. TalkTalk said that, [REDACTED]. TalkTalk said that quad-play was still at an early stage and, for example, while no-one could produce one single bill at present, all providers would eventually be able to do so.
29. TalkTalk said that, for loyal customers, it would be possible to give them mobile at a reduced rate because [REDACTED]. TalkTalk had been campaigning to make switching easier for eight years, and the move to quad-play would make the need for easy switching even more important. TalkTalk said that large companies would otherwise find it easier to tie customers into contracts and would have no incentive to encourage easier switching in the quad-play bundle. TalkTalk said that [REDACTED].
30. TalkTalk said that Ofcom had proposed easier switching on mobile, although that was some way away. TalkTalk said that, because easy switching was technically quite difficult, large incumbents could frustrate the regulator for a very long time. The combined entity would have a huge incentive to make switching more difficult, not easy.
31. TalkTalk said that it saw products sold on a standalone basis and through bundles as in the same market. TalkTalk said that there was an evolution towards more bundling, but that did not mean bundles now constituted a separate market.
32. [REDACTED]
33. TalkTalk noted that it was focused on the value end of handsets.

## **Business mobile**

34. TalkTalk said that BT was powerful in the fixed-line SME market, with approximately 50% market share. TalkTalk said that the combination of BT and EE would be extremely powerful, with very little scale competition. The next largest had 8%. TalkTalk said that the combined entity would build on BT’s very large presence in the fixed-line SME market, with by far the strongest 4G network, and this would make it very attractive to SMEs that wanted to bundle fixed and mobile (in the same way as consumers). TalkTalk said that [REDACTED].
35. TalkTalk said that there would be demand from all business segments for fixed/mobile bundles. [REDACTED] TalkTalk said that the merged entity would be quite

a dominant player in this space. TalkTalk had a relatively small business and had not yet launched a B2B bundled product. Virgin Media and Vodafone had a small presence. TalkTalk said that Sky was not active.

## **Impact of the merger in the retail mobile space**

36. TalkTalk said that there were undoubted synergy benefits in putting BT and EE together, but these would be passed on to BT shareholders and not to consumers. TalkTalk said that the merger would reduce competition in the market as a whole and enable foreclosure of quad-play providers in that market, which would enable the merged entity to charge higher prices. TalkTalk said that the merger would really risk reducing competition in a dynamic sense as the market moved increasingly towards quad-play. TalkTalk said that the merger may also mean less innovation (for example, because BT may not pursue its femtocell strategy).
37. TalkTalk said that the combined entity would not need to try as hard to acquire mobile customers as a standalone BT would, as it would need only to combine the existing customer sets. The merged entity would have a big incentive to price less aggressively in the consumer mobile market than it would have been otherwise, because it had a large premium back-book that it would have acquired from EE.
38. TalkTalk said that it observed that businesses with an entrenched position were reluctant to make step changes that undermined their existing base, and used Kodak as an example. TalkTalk said that competition in the market to date had driven investment by BT and EE. TalkTalk said that the threat of competition, whether from cable, companies unbundling local loop, mobile companies, etc, had prompted the investment that BT and EE had made. TalkTalk said that, if the combined entity could achieve a dominant position in quad-play, the incentive to innovate would rapidly dwindle. TalkTalk said that where they did innovate, the cost savings would not be passed on to consumers.
39. TalkTalk said that BT would have a huge incentive to frustrate innovation by other market participants and to frustrate others' access to quad-play (eg by foreclosing MVNOs active in fixed-line from access to wholesale mobile services).

## **Wholesale mobile**

40. TalkTalk said that the wholesale mobile market was not particularly competitive, with limited interest from MNOs. [✂]

41. [✂]
42. [✂]
43. [✂]
44. TalkTalk said that BT did not need to buy EE in order to get the vast majority of the benefits that it had been seeking with its strategy.
45. TalkTalk said that EE was very active in the market, through a scale MVNO with Virgin Media. [✂]
46. [✂]
47. [✂]
48. [✂]
49. [✂]
50. [✂]
51. TalkTalk said that migrations for a 'light' MVNO from one MNO to another were a major undertaking, requiring every customer receiving a new SIM card and switching the existing Vodafone SIM for an O2 SIM. TalkTalk said that the transition from light to 'thick' MVNO would mean that TalkTalk owned the SIM cards, the number ranges, etc.
52. TalkTalk said that migrations also involved billing systems, and these are usually done in batches. [✂]
53. TalkTalk said that the negotiation process from initial RFP to finishing migration took approximately [✂]. TalkTalk said that a full MVNO could do this in a shorter time period because it had its own SIM cards. [✂] TalkTalk considered it to be more relevant that it had the ability to bundle the mobile service in a way that could drive down costs to consumers.
54. [✂]
55. TalkTalk said that that recourse to Ofcom was a possibility where things went wrong in contract, but Ofcom had limited formal powers to remedy those types of problems and there was a significant lag effect. [✂]
56. TalkTalk said that a combined BTEE would be a wholesale MVNO provider that would be highly unlikely to supply TalkTalk on commercial terms. [✂] BT had been very explicit in public [✂] that BT Sports was an investment to expand its fixed base.

57. [X] The counterfactual did not make matters any better or worse here.

## **Wholesale broadband**

58. TalkTalk said that it was also concerned about an allocation of costs between Openreach and BT Global Services, BT Consumer and BT Business. TalkTalk said that the boundary between what was in Openreach and what would be in BT's mobile division was not a science. TalkTalk said that there was an art with where you drew the line in the network diagram and in the accounting. TalkTalk said that BT had a big 'pot' of central costs and this was going to get bigger post-Merger, which would potentially allow BT more flexibility to allocate more costs to regulated products. TalkTalk said that there was also a concern that the merger would increase the incentive on BT to allocate costs towards MPF and away from SMPF and WLR.
59. TalkTalk said that, as a result, the potential to abuse the existing accounting rules would be greater post-Merger, simply because the sums of money that could be used would be that much greater. TalkTalk said that it would also be unclear, for example, where mobile backhaul ended and the mobile core network or core IT began in terms of accounting allocation. TalkTalk said that Ofcom's review of accounting changes resulting from the Merger could take anything from three to seven years and, in the interim, BT had discretion to game the system.
60. TalkTalk considered the sums of money involved to be significant. TalkTalk said that, if the new costs allocation recently advanced by Ofcom was applied retrospectively, it would move £240 million yearly from Openreach regulated products to BT's unregulated products. TalkTalk said that its share of that was £40 million and this represented money charged to its customers that did not need to be.
61. TalkTalk considered that the merger would increase the ability for BT to move around common costs. TalkTalk said that the incentive was already there. TalkTalk said that what this meant in practice was that, post-Merger, BT would have an opportunity to reallocate costs. TalkTalk said that Ofcom would then undertake a review and possibly consultation and, if it found an issue, this might not be for three, four or even five years. TalkTalk said that even then, Ofcom may not apply any alternative allocation retrospectively.

## **VULA margin squeeze test**

62. TalkTalk was concerned that the VULA margin squeeze test was very complex and would not bind BT in relation to the pricing of its superfast broadband products. TalkTalk said that this test averaged the prices of the

different BT products together, rather than testing by individual products. TalkTalk said that this allowed BT to use that and trade at the low end and undercut margin on one product, but pass the total margin squeeze test. TalkTalk noted that the methodology was currently under appeal.

63. TalkTalk said that it was inherently complicated to design a piece of margin regulation for a bundled product. TalkTalk said that the test had only been live since April 2015, and Ofcom had already issued a proposal on how to take account of the new pricing of BT Sport. TalkTalk said that if mobile was added, you would have a very complex piece of regulation that would be mired in endless appeals.
64. TalkTalk said that the merger would make the situation much worse because of the complexities of bundles. TalkTalk said that the margin test was originally designed for a situation where there were lots of well-defined prices being paid for different services, ie because BT had to pay Openreach a set wholesale price. TalkTalk said that, post-merger, with sport and mobile, there would not be these well-defined external prices. TalkTalk said that, if BT owned EE, there would no longer be a well-defined price for the mobile access. TalkTalk said that, under an MVNO arrangement, this cost could have been recorded as an external unit price. TalkTalk said that, instead, it was necessary to allocate fixed costs, and there was no straightforward way of doing that.

## **Retail broadband**

65. TalkTalk said that it had bought the Virgin customers that were off its cable network, which covered roughly 45% of the UK. TalkTalk said that, in the rest of the country, where Virgin had broadband customers, they were wholesale customers of BT. In TalkTalk's view, [redacted]. TalkTalk said that the majority of these customers were on-network for TalkTalk, whose unbundled network covered 95% of the country. TalkTalk said that it therefore made sense to acquire them, because Virgin couldn't offer them fibre or TV. TalkTalk said that it was able to acquire these customers in bulk at a discount and so did not have to compete for them and persuade each to switch from Virgin to TalkTalk.
66. TalkTalk said that there was 5% of customers that were off-network and for which TalkTalk must source 'IP-Stream' from BT. TalkTalk said that these were in what Ofcom referred to as Market A1. [redacted]
67. TalkTalk said that the sale of this 5% of customers to Fleur Telecom [redacted]. It was not viable to operate in that market as a value brand so it was unclear how Plusnet did so.

68. TalkTalk said that in Market A there were some exchanges where it was just BT, and other exchanges where it was just BT and TalkTalk. TalkTalk said that Sky was not present in any exchanges where TalkTalk was not also present. [✂]
69. TalkTalk said that EE was present in Market A1 at the retail level and charged a premium for its product. TalkTalk said that EE's broadband base was growing based on its published net ads. TalkTalk said that EE was a viable alternative to BT products. TalkTalk said that the only alternative scale brands in those markets were BT and BT Plusnet. TalkTalk said that the latter price discriminated. TalkTalk said that Plusnet charged a premium like EE. EE was therefore the only competition to BT at the retail level in Market A1 where TalkTalk was not present.
70. TalkTalk said that, in terms of other resellers present in Market A, there was the Post Office (one of TalkTalk's wholesale customers), Telecom Plus and possibly Zen. TalkTalk said that none had large numbers. TalkTalk said that EE had the advantage of a national profile, brand and advertising and this made it a much stronger competitor than the other smaller niche players.
71. TalkTalk said that there were some exchanges in Market A that were in urban areas but physically too small to unbundle; for example, in Knightsbridge.

### **Superfast broadband (SFBB)**

72. TalkTalk said that 41% of BT's subscriber base were SFBB and these customers [✂].
73. TalkTalk said that it was [✂]. TalkTalk wanted to be the value for money provider. TalkTalk paid BT £8 a month for every customer taking fibre.
74. TalkTalk said that BT's approach differed as it bundled SFBB in for free because it wanted to expand its market share.
75. TalkTalk said that it considered that the markets for SFBB and standard broadband were becoming the same market as it was very dynamic. Ofcom's current view was that 10Mb/s was sufficient for most customers. TalkTalk said that for customers in households where copper could deliver that speed, they may not be as interested in SFBB. TalkTalk said that for customers where copper was lower speed, they may look to upgrade to fibre. TalkTalk said that increasingly, copper and fibre was becoming one market. TalkTalk said that customers that had made the switch to fibre were less likely to switch back to copper. TalkTalk said that there may therefore be an asymmetric competitive constraint that fibre placed on copper, but not vice versa.

76. TalkTalk said that it had a positive incentive to sell fibre, even though it had to buy it at the wholesale level from BT, [redacted]. TalkTalk said that there were some customers for which the move to SFBB would not be economical (particularly if their copper speeds are sufficient).
77. TalkTalk said that, in relation to EE, it had observed that it had been quite sporadic in its promotional activity. TalkTalk said that when EE was running promotions, TalkTalk saw the impact on customer switching.
78. TalkTalk said that it expected the penetration of fibre to the cabinet (FTTC) to grow over time.

## **Other questions**

79. TalkTalk said that it considered there to be a real risk of potential coordination in the market for wholesale mobile as a result of a reduction in the number of players. TalkTalk had seen no evidence to suggest this was happening at present, but considered that the merger would make this more likely. [redacted]
80. TalkTalk said that there was the potential for conglomerate effects given that the market for fixed and mobile technologies, the networks themselves and the consumer propositions were becoming blurred. TalkTalk said that too narrow an analysis may miss a wider negative impact on the market in the next three to five years.
81. TalkTalk said that, in relation to the counterfactual, it was very challenging to establish what it was at phase 2. TalkTalk noted that this was particularly true given that the H3G/O2 merger was anticipated, being looked at by a different competition authority, and it was not clear what the outcome would be. TalkTalk suggested that the best approach was to look at consolidation in other European markets where there had been similar deals, which had also involved H3G. TalkTalk noted that the remedies in those cases (Austria, Germany, Ireland) had been thoroughly ineffective in remedying the harm in the MNO market. TalkTalk said that this was because they had focused on creating some new kind of super-MVNO rather than restoring competition at the upstream MNO level.