Anticipated joint venture between Liberty Global Plc and Telefónica S.A.

Issues statement

21 January 2021

The reference

1. On 11 December 2020, the Competition and Markets Authority (CMA), in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act), referred the anticipated joint venture (JV) between Liberty Global plc (Liberty Global) and Telefónica S.A. (Telefónica) to merge their operating businesses in the United Kingdom (UK), that is Virgin Media Inc. (Virgin) and O2 Holdings Limited (O2) respectively (the Proposed Merger) for further investigation and report by a group of CMA panel members (the Inquiry Group). [1]

2. Throughout this issues statement, where appropriate, we refer to Liberty Global and Telefónica collectively as 'the Parties' and the JV as 'the Merged Entity'.

3. In exercise of its duty under section 36(1) of the Act, the CMA must decide:

   (a) Whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and

   (b) if so, whether the creation of that relevant merger situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

4. In answering these questions, we will apply a 'balance of probabilities' threshold to our analysis. That is, we will decide whether it is more likely than not that the Proposed Merger will result in an SLC.[2]

[1] The reference was made under the CMA fast track procedure. See Mergers: Guidance on the CMA's jurisdiction and procedure (2014), paragraphs 6.61 to 6.65.
[2] Mergers: Guidance on the CMA's jurisdiction and procedure (2014), paragraph 3.7.

Overview of the scope of the inquiry

5. We intend to focus our inquiry on the vertical relationships between the Parties where the CMA's Phase 1 decision found that there may be potential for a reduction in competition. A vertical relationship is a business to business transaction along the supply chain. The two vertical relationships that we particularly intend to consider in this inquiry are:

   (a) O2's supply of wholesale mobile services to companies who run mobile virtual networks (MVNOs), particularly those who offer consumers packages of products including mobile, fixed line telephony, broadband and pay-TV (fixed-MVNOs), such as Sky; and

   (b) Virgin's supply of wholesale leased lines to mobile network operators (MNOs) that enable these operators to connect key parts of their network. Wholesale leased lines are essential for the functioning of the mobile phone network and also important to the development of 5G.

6. We explain these potential concerns in more detail later in this document.

7. The Phase 1 decision found that there are limited overlaps between the Parties at retail level. These overlaps occur in the supply of retail mobile, fixed telecoms and some business services. The Phase 1 decision found that the JV would not be expected to significantly strengthen the Parties' position in these markets.

8. Although we are not precluded from considering any other issues which we may identify during our investigation, we are only likely to consider such issues in light of new evidence being brought to our attention by third parties. We consider this to be a proportionate way in which to conduct this inquiry.

Purpose of this issues statement

9. In this statement, we set out the main issues we are likely to consider in reaching our decision on the SLC question (see paragraph 3(b) above), having had regard to the evidence available to us to date.

10. We are publishing this statement in order to assist parties (including the Parties and third parties) with the submission of their evidence for the purpose of our investigation. We invite parties to notify us if there are any additional relevant issues which they believe we should consider.

11. We are publishing this issues statement during the Coronavirus (COVID-19) pandemic, which is having a significant impact on consumers and

business across the world. The CMA has published a statement on its website on how it has adjusted its working arrangements in response and guidance on key aspects of its practice during the pandemic. Our approach to evidence-gathering will take into account the difficulties that the pandemic may be causing for market participants in this sector. If appropriate, we will also take into account the impact of the pandemic in our assessment of the competitive effects of the Proposed Merger, although we are required to look beyond the short-term and consider what lasting structural impacts the Proposed Merger might have on the markets at issue.

Background

The Parties

12. Telefónica is the holding company of an international group of telecommunications companies. In the UK, Telefónica operates O2 as an MNO, offering retail mobile services to consumers and businesses as well as wholesale mobile services to MVNOs.

13. O2 owns giffgaff Limited (an MVNO) and has shareholdings in the Tesco Mobile joint venture (another MVNO), CTIL (a mobile network-sharing joint venture with Vodafone) and Digital Mobile Spectrum Limited (a joint venture in which Three, EE and Vodafone also hold shareholdings). O2 also provides certain retail fixed services, including voice and data connectivity, to business customers. The turnover of Telefónica in the financial year 2019 was approximately £42,463 million worldwide and £6,234 million in the UK.[3]

14. Liberty Global is an international video, broadband and communications company. In the UK, it operates Virgin which provides retail fixed telecommunications services (specifically voice and broadband), retail pay-TV services and wholesale fixed telecommunications services. These include an up-stream fibre-optic network which provides data connectivity across much of the UK; Virgin is one of the two main suppliers of this connectivity to MNOs. Virgin also supplies retail mobile services as an MVNO (Virgin Mobile). The turnover of Liberty Global for the financial year

[3] Phase 1 decision, paragraph 10. Note, turnover figures converted from EUR to GBP based on Bank of England average exchange rate for 2019.

2019 was approximately £10,766 million worldwide and £[✂] million in the UK.[4]

The transaction

15. On 7 May 2020, the Parties entered into an agreement under which Telefónica and Liberty Global will contribute their respective UK businesses to the JV and each be allotted 50% of the JV's share capital:

(a) Liberty Global will contribute to the JV its wholly owned subsidiary Virgin Media Inc., the parent company of Virgin Media Ltd (Virgin Media) and Virgin Mobile Telecoms Ltd; and

(b) Telefónica will contribute to the JV its wholly owned subsidiary O2 Holdings Limited, the parent company of operating businesses including Telefónica UK Limited, Tesco Mobile Limited and giffgaff Limited.

16. On the same date, the Parties also entered into a shareholders' agreement which governs how the JV will be owned, controlled and managed.

17. The Proposed Merger is not yet complete and is conditional upon clearance by the CMA. The Proposed Merger is not being reviewed by any other competition authority.

Our inquiry

18. Below we set out some specific areas of our intended assessment in order to help parties who wish to make representations to us. We will also, during the course of our inquiry, seek to establish key characteristics of how the industry operates and understand the rationale for the Proposed Merger and any relevant and foreseeable industry developments, including the impact of the growth of 5G mobile, the roll-out of fibre-optic networks and any other relevant issues.

Counterfactual

19. We will assess the potential effects of the Proposed Merger on competition compared with the competitive conditions in the

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[4] Phase 1 decision paragraph 9. Note, turnover figures converted from EUR to GBP based on Bank of England average exchange rate for 2019.

counterfactual situation (that is, the competitive situation that would be likely to prevail absent the Proposed Merger).

20. In the Phase 1 decision, the CMA found that the pre-merger situation was the appropriate counterfactual. Our starting point for this phase 2 investigation is that the relevant counterfactual is the prevailing conditions of competition between the Parties. We will examine whether this is the appropriate counterfactual, taking into account any new information that comes to light.[5]

Market definition

21. Market definition provides a framework for assessing the competitive effects of a merger. It involves an element of judgement. The boundaries of a market do not determine the outcome of the analysis of the competitive effects of a merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. We will take these factors into account in our competitive assessment.[6]

22. In practice, the analysis of market definition and of the competitive effects will overlap, with many factors affecting market definition being relevant to the assessment of competitive effects and vice versa.[7]

23. As described below, we have identified primary potential theories of harm in relation to two areas of the Parties' operations:

    (a) Wholesale mobile services provided by MNOs allow MVNOs access to the MNO's radio access network. Wholesale services also include call origination and may include other services. O2 currently supplies wholesale mobile services to a number of MVNOs, the largest one being Sky Mobile; and

    (b) wholesale leased lines are supplied to MNOs for mobile backhaul; this is the connection of their radio base stations to their core network. Virgin Media currently supplies mobile backhaul to a range of MNOs.

[5] Merger Assessment Guidelines, section 4.3.
[6] Merger Assessment Guidelines, paragraphs 5.2.1-2.
[7] Merger Assessment Guidelines, paragraph 5.1.1.

24. In relation to these potential theories of harm, in the Phase 1 decision, the CMA defined the frames of reference, respectively, as:

(a) The supply of wholesale mobile services in the UK; and

(b) the supply of passive fibre leased lines at each of the access and aggregation layers on a local basis.[8] [9]

25. We will consider these frames of reference, and we will also consider alternative, broader market definitions, including the extent to which active fibre leased lines and passive fibre leased lines represent competitive alternatives for MNOs.

26. We will consider the evidence gathered at Phase 1 and any new evidence we receive which is relevant to the appropriate market definition for our assessment of the Proposed Merger. We will consider, where appropriate, out of market constraints on the Merged Entity as part of our competitive assessment.

Assessment of the competitive effects of the Proposed Merger

Theories of harm

27. Theories of harm describe the possible ways in which an SLC may be expected to result from a merger and provide the framework for analysis of the competitive effects of a merger.

28. We set out below the theories of harm that we are currently planning to investigate. We may revise our theories of harm as the inquiry progresses and the identification of a theory of harm does not preclude an SLC being identified on another basis following further work, or our receipt of additional evidence.

[8] Phase 1 decision, paragraph 31 (a) and (b).

[9] Passive fibre leased lines, also called dark fibre, are unlit fibre on which customers install and manage their own electronic equipment at both ends of each line. (In contrast, active fibre leased lines include both the fibre infrastructure and some or all of the necessary electronic equipment.) The access layer is the leased lines typically connecting the MNO's radio base station to an access aggregation node; the aggregation layer is the leased lines connecting access aggregation nodes to backhaul aggregation nodes, backhaul aggregation nodes with each other, and backhaul aggregation nodes to core nodes. Supply was considered on a local basis in line with Ofcom's definition of these markets on a local basis, rather than as a single national market.

29. We are currently considering two vertical effects theories of harm. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitor of the supplier's customers.[10] The CMA's approach to assessing vertical theories of harm is to analyse three aspects: the ability of the Merged Entity to foreclose competitors; the incentive for it to do so; and the effect of foreclosure on competition.[11]

Input foreclosure in the supply of wholesale mobile services to MVNOs

30. The first vertical effects theory of harm that we intend to assess is input foreclosure in the supply of wholesale mobile services to MVNOs.

31. The concern under this theory of harm is that, as a result of the Proposed Merger, the Merged Entity could withhold or deteriorate its supply of wholesale mobile services to rival MVNOs. If the Merged Entity was to engage in input foreclosure, this would lead to reduced choice of wholesale mobile suppliers for MVNOs and potentially worse terms which could in turn affect retail competition. The incentive for the Merged Entity to do this would arise if the customers of the affected MVNOs move their business to the Merged Entity.

32. We will consider potential foreclosure of all MVNOs but we will give particular consideration to the potential for input foreclosure of fixed-MVNOs.[12] At Phase 1, the CMA found that fixed-MVNOs are the segment of the market in which the Merged Entity's incentives may differ from O2's incentives prior to the Proposed Merger. This is because O2 currently supplies wholesale mobile services to fixed-MVNOs and it does not offer fixed/mobile bundles to retail customers to any significant extent.[13] Post-merger, the Merged Entity will be able to offer fixed/mobile bundles and will therefore compete with fixed-MVNOs. These include Sky, which currently purchases wholesale mobile services from O2, and any other fixed-MVNOs who may wish to negotiate a wholesale mobile contract.

33. We will investigate whether the Merged Entity would have the ability and/or the incentive to engage in input foreclosure in the supply of

[10] Merger Assessment Guidelines, paragraphs 4.1.4 and 5.6.6.
[11] Merger Assessment Guidelines, paragraph 5.6.6.
[12] See paragraph 5(a) for definition of fixed-MVNOs.
[13] Fixed/mobile bundles include retail mobile services sold together with one or more fixed services.

wholesale mobile services to MVNOs, and the effect of any such foreclosure at the retail level. In particular, we will assess:

(a) The ability of the Merged Entity to foreclose by, for example, assessing the extent to which O2 refusing to supply, or deteriorating the terms or quality of its supply of, wholesale mobile services would weaken the position of MVNOs and so could affect their competitive position at the retail level;

(b) the incentive of the Merged Entity to foreclose MVNOs, including the degree to which a foreclosed MVNO's retail customers might be expected to switch to products sold by the Merged Entity. In particular, we will consider the possibility that the Merged Entity may gain customers from fixed-MVNOs and the relative profitability of wholesale and retail services; and

(c) if the Merged Entity had the ability and incentive to engage in a foreclosure strategy, what would be the effect on customers. For example, in the event that fixed-MVNOs were foreclosed, we will assess the extent to which the Merged Entity will face competition in the provision of fixed/mobile bundles from other suppliers of fixed/mobile bundles (such as BT), and/or the extent to which unbundled services compete with bundled services.

34. Subject to new evidence on this being submitted, we do not intend to assess customer foreclosure: that is, the effect on competition of the removal of Virgin Mobile as a customer of wholesale mobile services. The Proposed Merger means that Virgin Mobile will be supplied with wholesale mobile services by O2 and not by a third party. Against the background of ongoing strong growth in data traffic, we do not consider that Virgin Mobile is likely to be an important MVNO customer in terms of the viability of suppliers of wholesale mobile services and any resulting impact on the competition in the wholesale market.

Input foreclosure in supply of wholesale leased lines to MNOs

35. The second vertical effects theory of harm that we intend to assess is input foreclosure in the supply of wholesale leased lines to MNOs. MNOs use these leased lines as mobile backhaul, that is to connect their radio base stations and their core network.

36. The Phase 1 decision found that Virgin Media is the second largest provider of mobile backhaul to MNOs in the UK after BT Openreach.[14]

37. The concern under this theory of harm is that, as a result of the Proposed Merger, the Merged Entity would have both the ability and the incentive to engage in input foreclosure in the supply of its wholesale leased lines to rival MNOs, in particular with respect to passive fibre leased lines. Foreclosure could be effected by, for example, increasing the price, reducing service quality, changing the offering (for example, by stopping or delaying the roll-out of passive fibre leased lines so as to reduce those MNOs' network coverage), or offering only active fibre leased lines.

38. We will investigate potential input foreclosure for each of the access and aggregation layers[15] in terms of:

(a) The ability of the Merged Entity to foreclose rival MNOs. This will include an assessment of: the cost of mobile backhaul relative to MNOs' overall costs; MNOs' ability to switch to alternative sources of mobile backhaul (including active fibre leased lines); and any restrictions imposed on the Merged Entity by existing contracts and/or network sharing agreements;

(b) the incentive that the Merged Entity would have to foreclose rival MNOs, by assessing the likely commercial gains at the retail level (including the impact an increase in price or degradation in quality would have on affected MNOs, how this would translate into a change in their retail offering and the likely diversion of customers to the Merged Entity as a consequence), and the likely losses at the wholesale level; and

(c) the effect that the foreclosure would have on competition at the retail level. Our assessment will take into account the role of regulation as well as market developments such as the roll-out of 5G technology.

39. Subject to new evidence being submitted, we do not intend to assess customer foreclosure in relation to fibre leased lines. The Proposed Merger could lead to a larger share of O2's mobile backhaul requirements being supplied by Virgin Media, hence removing this business from other suppliers of wholesale leased lines. However, following the Proposed Merger, these suppliers will continue to be able to sell fibre leased lines for mobile backhaul to Vodafone and Three.

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[14] Phase 1 decision, paragraph 44.

[15] See footnote 9 to paragraph 24 (b) for definition of these

Other potential theories of harm

40. The Proposed Merger will also result in some horizontal overlaps and further vertical links. As stated above, subject to new evidence being submitted, we do not plan to investigate the effect of these areas.

41. There will be a horizontal overlap between the Parties in relation to retail mobile services where O2 and Virgin Mobile are both active. We do not plan to investigate this, given that evidence we have seen to date suggests that Virgin Mobile has a low and declining market share at the retail level. We have also seen evidence that suggests that O2 and Virgin Mobile are not close competitors, in particular Virgin focusses on attracting mobile customers by cross selling its mobile offering as an add-on to its fixed services. Finally, we note that the European Commission and CMA have previously found MVNOs, such as Virgin Mobile, do not act as a strong competitive constraint on MNOs (in particular due to an MVNO's lack of 'owner economics.'[16])[17]

42. The Parties overlap in the supply of retail broadband, retail voice, retail business connectivity, retail internet hosting and IT services. Evidence we have seen to date shows that the Proposed Merger would result in small increments in each of these and that the Parties do not compete closely in these areas.

43. The Parties also have vertical links in relation to the supply of wholesale services for international roaming, call termination and hosting of calls to non-geographic numbers, wholesale call origination at a fixed location, wholesale domestic call transit and wholesale international carrier services. Evidence we have seen to date shows that the Merged Entity would have no ability to foreclose these services, due to the presence of other significant rivals who could supply any customers that the Merged Entity would attempt to foreclose.

Countervailing factors

44. We will consider whether there are countervailing factors which are likely to prevent or mitigate any SLC that we may find, such as:

[16] That is, their dependence on a wholesale contract, which implies higher costs per additional customer served, than is the case for MNOs who have higher fixed costs but lower variable costs.
[17] See for example CMA report on the anticipated acquisition by BT Group plc of EE Limited, paragraph 14.197, and European Commission, Hutchison / Telefonica, 11 May 2016, paragraph 969.

(a) Evidence of entry and/or expansion by third parties and whether entry and/or expansion would be timely, likely and sufficient to prevent any SLC from arising as a result of the Proposed Merger;[18]

(b) evidence in relation to countervailing buyer power;[19] and

(c) evidence in relation to efficiencies arising from the Proposed Merger.[20]

Possible remedies and relevant customer benefits

45. Should we conclude that the Proposed Merger may be expected to result in an SLC within one or more markets in the UK, we will consider whether, and if so what, remedies might be appropriate.

46. In any consideration of possible remedies, we may in particular have regard to their effect on any relevant customer benefits that might be expected to arise as a result of the Proposed Merger and, if so, what these benefits are likely to be and which customers would benefit.[21]

Responses to this issues statement

47. Any party wishing to respond to this issues statement should do so in writing, by **no later than 5pm on 4 February 2021** by emailing virgin.o2@cma.gov.uk.

48. Please note that, due to the ongoing COVID-19 pandemic, the CMA's offices across the UK are closed until further notice. We are unable to accept delivery of any documents or correspondence by post or courier to any of our offices.

[18] Merger Assessment Guidelines, paragraph 5.8.3.
[19] Merger Assessment Guidelines, section 5.9.
[20] Merger Assessment Guidelines, paragraph 5.7.4.
[21] Merger Remedies (CMA87), paragraphs 3.4 and 3.15 to 3.24.