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Three/Vodafone: A pathway to approval

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Despite identifying competition concerns, the CMA has outlined a set of remedies that could lead to approval of the merger. In doing so it would transform the UK's mobile market while helping to deliver government ambitions for connectivity and economic growth.

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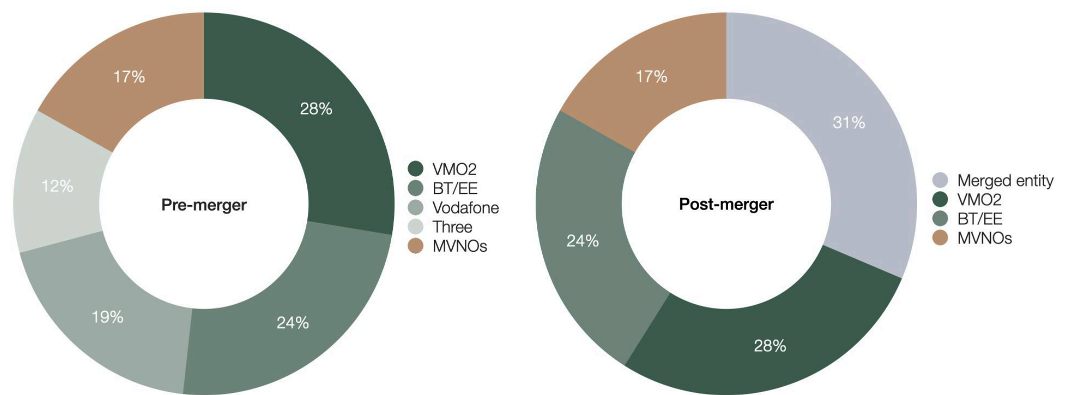
- On the face of it, things don't immediately appear positive. The CMA's provisional findings in the Phase 2 review conclude that the deal would weaken retail competition through the loss of a mobile network operator, while also expecting that the merged entity would compete less intensely in the wholesale market.
- Initial concerns around network sharing, however, have fallen away, potentially as a result of the deal struck between Vodafone and Virgin Media O2 to extend and enhance Project Beacon. This may explain why spectrum has featured surprisingly little during the review process, with Virgin Media O2 in line to acquire frequencies from the merged entity if the deal is approved.
- It is significant that the CMA's notice of possible remedies leads with a behavioural commitment to investment, rather than a structural carve-out of assets, such as spectrum and/or towers. It will be particularly encouraging to Three and Vodafone that a structural commitment – that would facilitate a new entrant – is essentially off the table.
- Improved wholesale access for MVNOs and time-limited protections against price rises are proposed, but as ancillary remedies only. These measures appear proportionate, but may ultimately not be required or it might not be possible to identify a willing and suitable remedy taker.
- With it generally being the case that the CMA doesn't diverge from its provisional findings at this stage, attention will soon turn to its final report and agreement on commitments. Approval with behavioural remedies would not only be a positive outcome for the parties, but also a win for the new Government and its desire for investment to spur economic growth.

On the face of it, the CMA is concerned about a weakening of competition at both the retail and the wholesale levels

On 13 September 2024, the Competition and Markets Authority (CMA) released its provisional findings in the Phase 2 review of the proposed merger of Three and Vodafone in the UK. When announcing the transaction, Margherita Della Valle (CEO, Vodafone Group) claimed it would be "great for customers, great for the country and great for competition", while Robert Finnegan (CEO, Three UK and Ireland) stated that it represents a chance to "close the 5G gap" on leading European markets, previously describing the UK mobile industry as "dysfunctional" and "overcrowded". The deal would reshape the mobile market, creating a new leading operator by share of subscribers – see *Figure 1*. Despite concerns from some politicians about Three's parent company CKHGT's links to China, the merger has been approved by the UK Government under the National Security and Investment Act 2021, subject to conditions.

Figure 1
Mobile subscribers in the UK
Market shares (%)



Source: Assembly

Clearance for in-market mobile consolidation on competition grounds – especially four-to-three mobile mergers such as this one – has not been easy to come by. Competition authorities have often required onerous (and at times illogical) commitments to alleviate concerns, occasionally (as was the case in Denmark) resulting in deals to be abandoned. In the UK, Three's attempt to acquire O2 in 2015 faced stiff opposition from both the CMA and Ofcom. As such, the bar for approval was always going to be high.

Despite Three and Vodafone's claims that they are sub-scale and each earn below their cost of capital, the CMA's counterfactual took the view that absent the deal the parties would continue to invest and compete with each other and with other mobile operators, noting Three's focus on improving its network quality and increasing the adoption of its fixed wireless access (FWA) proposition, as well as Vodafone's plans for investing in standalone 5G. On 22 March 2024, the CMA completed its initial Phase 1 review, identifying the prospect of a substantial lessening of competition (SLC) arising in the supply of

both retail and wholesale mobile services, as well as due to the merged entity's participation in the country's two network shares (Project Beacon and MBNL). It subsequently referred the merger for an in-depth Phase 2 investigation. In its Phase 2 provisional findings, the CMA dropped its concerns relating to network sharing, settling on two theories of harm (TOH):

1. **Retail mobile services:** The CMA considers that the merged entity and its competitors are likely to have the incentives to raise prices or degrade non-price aspects of their offerings (e.g. by reducing investment) due to the elimination of a competitive constraint between Three and Vodafone, and that the merged entity would have a lower incentive to compete aggressively compared to each party on a standalone basis; and

2. **Wholesale mobile services:** The CMA is concerned that the merged entity may have a reduced incentive to compete for opportunities to host MVNOs than Three and Vodafone individually because the transaction will lead to the removal of the constraint the parties currently exert on each other.

Concerns around network sharing agreements have fallen away, while spectrum featured surprisingly sparingly during the review process

The CMA's Phase 1 investigation raised the risks of the merged entity gaining access to its competitors' commercially sensitive information (e.g. data on investments, information on deployment plans or technical specifications) through its participation in both Beacon and MBNL, and being able to use that to compete less aggressively as it may be able to predict its rivals' strategies. This was a major concern in the Three/O2 merger review in 2015/16, and a primary reason why the deal was blocked. In that case, the EC considered that a merged entity straddling both partnerships could raise antitrust issues and hamper the development of mobile infrastructure in the UK.

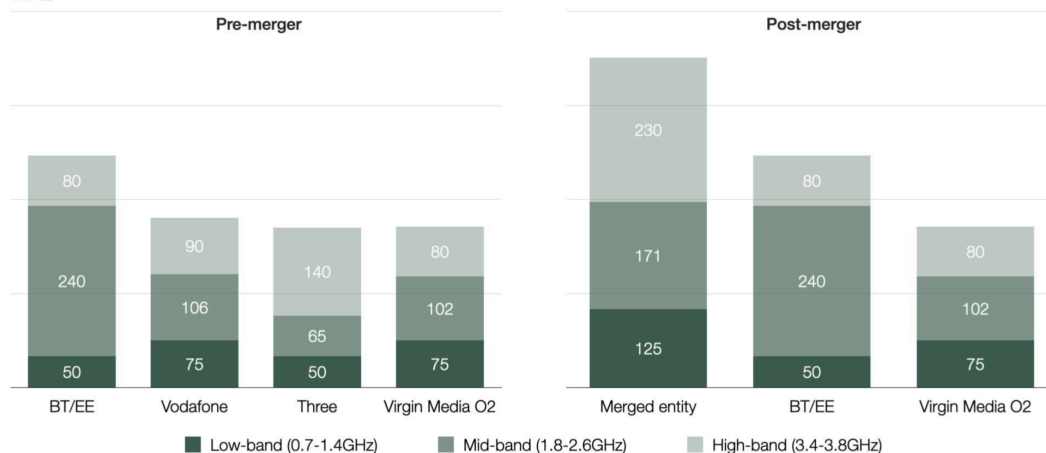
BT echoed the CMA's assessment, while also highlighting the potential for disruptions to MBNL – its network sharing joint venture (JV) with Three – that would impact BT's ability to compete. However, network sharing was ultimately not a major obstacle to the Three/Vodafone deal, with competition issues relating to the two existing agreements seemingly easier to overcome than in the past. The CMA considered the impact of the merged entity's participation in Beacon and MBNL on operators' collective incentives to invest and compete. It stated that there is already a certain level of information sharing pre-merger, before concluding that Three/Vodafone would likely not have the incentive to breach current information sharing safeguards nor to reduce or postpone planned investments based on any newly-gained knowledge.

Developments during the Phase 2 review may have contributed materially to network sharing falling away as the CMA's third TOH. On 3 July 2024, Vodafone and Virgin Media O2 announced that they had agreed to extend and enhance their existing mobile network sharing agreement – Beacon – for over a decade, with the aim of improving coverage and services across the UK. Taken together with the fact that MBNL is due to expire in 2031, if not sooner, and the less

integral role network sharing has played in 5G deployments compared with 3G and 4G rollouts, it is understandable why the CMA decided to drop its concerns in this area from the Phase 2 provisional findings.

Spectrum was an issue many considered would be a focus of the CMA, particularly as it has been a source of concern in recent mobile mergers in other countries, with divestment a common remedy to secure approval. Post-merger, Three/Vodafone would own 46% of total spectrum below 6GHz, BT/EE would hold 32% and Virgin Media O2 would hold 22%. The biggest asymmetry would relate to valuable C-band spectrum (i.e. 3.4-3.8GHz), where Three/Vodafone would have 59% – see *Figure 2*. Regulators have typically aimed to ensure a reasonably balanced distribution of spectrum; however, this was mentioned only twice in the CMA's Phase 1 decision summary. Despite the asymmetry between operators, the CMA's Phase 1 decision did not explicitly highlight this as a major competition concern. It stated that mobile operators require a balance of spectrum to provide coverage and capacity, with the latter a key determinant of network quality, while recognising the scope for different spectrum holdings to influence an operator's reliance on, or incentives to cooperate in or even frustrate, a network sharing agreement.

Figure 2
Spectrum holdings in the UK
MHz



Note: Holdings exclude any spectrum trade between the merged entity and Virgin Media O2
Source: Assembly, CMA

BT's response to the Phase 2 issues statement argued that the merged entity would have a disproportionate share of the UK's mobile capacity and spectrum to a level that would be unprecedented in Western European markets, harming competitors' investment incentives. Although it was expected that spectrum might attract further attention as the review progressed, this turned out not to be the case, potentially as a direct result of the Virgin Media O2/Vodafone agreement, which would also see Virgin Media O2 acquire spectrum at "market value" from the newly-created company. While details on the spectrum band(s) or amount that would change hands post-merger are not yet public, that transfer of frequencies would help rebalance the UK's mobile market by establishing three scaled network operators, each with a more closely aligned

spectrum holding. According to the CMA, it would provide a notable and rapid increase in network quality for Virgin Media O2's wholesale and retail customers, which would further increase infrastructure competition. With no similar agreement in place with either of the merging parties, BT is likely to feel somewhat aggrieved, particularly in light of its opposition to Ofcom's consultation on UK Broadband's proposed licence variation in the 3.9GHz band that would offer Three an additional capacity boost.

The ability and incentive to deliver at least some of the claimed network improvement efficiencies

Three and Vodafone have argued that combining their businesses would result in improved coverage and reliability for consumers from 'day one' (understood to mean within 12 months of the merger closing) at no extra cost, while delivering economic and employment benefits for the country. The parties have also outlined an £11bn network capex plan for the next 10 years (with £6bn in the first five years), which they claim would prompt BT/EE and Virgin Media O2 to invest more in their own networks. While investigating the potential risks to competition, the CMA has also considered whether there are 'countervailing factors' that prevent or mitigate any SLC arising from the transaction, including rivalry-enhancing efficiencies and relevant customer benefits.

During Phase 1, the parties made submissions to the CMA, which were based on certain assumptions about future investment, including the number of sites and amount of spectrum deployed. At that stage, the CMA stated that it did not believe these plans took into consideration the competitive landscape post-merger and considered that the parties' assumptions therefore needed a more detailed assessment. That focused on what the likely impact on network quality (and therefore competition) would be if the merger was to take place, levering the parties' 'joint business plan' (JBP), which includes a 'joint network plan' (JNP). Amid concerns that the CMA was not quite grasping the detail of the technical issues under discussion, it's encouraging to see Ofcom offer greater support by seconding additional staff. Ultimately this is likely to have improved the CMA's understanding of the market.

Despite a number of practical implementation risks to integrating the two firms, the CMA has provisionally concluded that Three and Vodafone are likely to have the ability to deliver the JBP; however, it also considers that the parties are not likely to do so in full. The CMA believes that the commercial strategies of the merged entity would respond dynamically to market circumstances, meaning it would reassess (and potentially reduce) the scale of network investment, e.g. in establishing new sites, in light of future developments. In addition, the CMA has serious concerns about the robustness and predictive value of the parties' quantitative modelling of the expected network capacity and quality impacts of the merger, including the £1.8bn welfare gain, and is therefore unable to put any weight on this or the associated claims.

Nevertheless, the CMA states that it does (currently) consider that Three and Vodafone have the ability to, and are likely to, deliver some of their claimed

network improvement efficiencies. For example, the deployment of a multi-operator core network arrangement (MOCN) arrangement and the parties' combined spectrum assets would help address congestion and boost capacity. The CMA also states that the merger should improve reliability, particularly in rural (but populated) areas and in buildings as a result of the greater number of sites, adding that MOCN would lead to some increase in geographic coverage – i.e. a removal of mobile 'not-spots'. Further, it considers that these overall improvements would likely lead to some competitive response from BT/EE and Virgin Media O2 to also enhance their respective network quality, increasing competition in the retail market. The CMA has remained sceptical about the potential benefits of the merger, and has provisionally concluded that it does not result in efficiencies that would offset its anti-competitive effects. However, the CMA has used wisely the extended Phase 2 timeline and the expert input of Ofcom to better appreciate the potential upsides, representing a positive shift in position and indicating a favourable response to the parties' oral hearings and evidence submissions.

The CMA's notice of possible remedies leads with a behavioural commitment to investment, rather than a structural remedy involving the transfer of assets

Since announcing the merger, the parties were eager to downplay the need for commitments to offset the possible impact on competition. Vodafone stated that it did not see the transaction as "compatible with any kind of disruptive remedies", while Three and parent company CKHGT argued that if the CMA was to seek heavy commitments, it would be reducing the deal's value and its pro-competitive effects. While unconditional clearance – as once suggested by Della Valle – was always going to be extremely unlikely, it seems the CMA may be broadly aligned with the parties' assessment. Its initial view is that there are case specific facts that indicate that behavioural remedies could be appropriate to address the identified SLCs. To that end, the CMA has proposed the following potential remedies for stakeholder comment:

A. **Network investment commitment** requiring the parties to deliver on the investments outlined in the JBP/JNP;

B. **Time-limited retail protections** for retail customers during the initial years of network integration and rollout under the investment commitment; and

C. **Wholesale market remedies** such as pre-agreed terms or capacity for MVNOs that could be combined with the investment commitment.

Three and CKHGT contended that some remedies imposed in the past "would simply not be on" in a Three/Vodafone context. In several previous deals reviewed by the EC, the merging parties have been required to make concessions to alleviate competition concerns, with spectrum divestment and MVNO access the most common remedies – see *Table 1*. However, in Italy, the EC required the creation of a new mobile network operator (Iliad) to mitigate the impact of the merger. Iliad has since sought to reconsolidate the Italian mobile market, which has remained intensely competitive (particularly in the low-cost segment),

although it now appears likely Vodafone will secure an exit via a sale to Swisscom. In February 2024, the EC completed its Phase 2 review of Orange/MasMovil, clearing the proposed JV with conditions. Here, the EC accepted commitments from the parties that would strengthen existing player Digi, namely spectrum divestment and optional national roaming.

Table 1
Commitments in recent mobile mergers in Europe

Country	Merging parties	Date of approval	Commitments submitted to the EC
Austria	H3G/Orange	2012	MVNO access, Spectrum divestment
Germany	Telefónica/E-Plus	2014	MVNO access, Spectrum divestment, Wholesale
Ireland	H3G/Telefónica	2014	MVNO access, Spectrum divestment, Network sharing
Italy	H3G/WIND	2016	Spectrum divestment, Roaming
Netherlands	T-Mobile/Tele2	2018	N/A (cleared unconditionally)
Spain	Orange/MasMovil	2024	Spectrum divestment, Roaming

Source: Assembly

The CMA considers that a structural remedy, i.e. a carve-out of assets to facilitate a new entrant (as was required in Italy and Spain), in the case of Three/Vodafone would not be effective. It states that such a “partial divestiture remedy” may not be practical, might not create a fourth operator capable of competing effectively and would unwind economies of scale gained through the merger. This would have been a red line for the parties as it would have undermined the strategic rationale for the deal in the first place. Encouragingly, the CMA has instead focused on a legally-binding investment commitment overseen by Ofcom, which would have the potential to enhance competition in the relevant markets. The parties have stated that their £11bn network capex plan would make investment in the UK higher than anywhere else in Europe. In none of the mergers listed in *Table 1* was this kind of pledge regarding investment proposed to, or indeed accepted by, the EC. The CMA’s proposal may well therefore be a novel solution – or at least a very rarely used one in the context of merger control. However, following the release of the Wireless Infrastructure Strategy, the commitment (in addition to an expectation about jobs) arguably came at an opportune moment. It is also the exact thing the new, pro-growth Labour Government would want to see, and should also be welcomed by DSIT if – as the parties claim – it enables investment to be made in a more targeted way, for instance to help tackle the urban-rural divide in mobile connectivity.

Improved wholesale access for MVNOs and protections against price rises are on the table, but as ancillary remedies only

It was expected that Three and Vodafone might be required to propose commitments designed to protect retail competition, including supporting those MVNOs already in the market with some scale. This is something the parties would have foreseen, and it is a more palatable option than the creation of a new fourth mobile network operator. The CMA is consulting on two possible wholesale remedies:

1. **Wholesale access terms**, including prices, being made available to MVNOs, subject to a reasonable limit (number of MVNOs or network capacity utilisation); and
2. **Capacity ring-fencing**, with a proportion of the merged entity's network capacity reserved exclusively for MVNOs.

The questions that should spring to mind in light of these potential measures relate to: i) whether they are needed; and ii) who would be the likely remedy taker(s). On the first issue, the UK already has a healthy and competitive MVNO market, with around 150 operating at the retail level, setting it apart from many other countries, e.g. Australia or France. Independent MVNOs (i.e. those not directly controlled by, or a sub-brand of, a mobile network operator) have almost 15m subscribers, representing a 17% market share – up from 11% in 2018. While wholesale access commitments in Austria and Ireland saw new players enter the market, these countries were home to only a handful of MVNOs with a relatively small collective subscriber base, presenting the EC with a clear opportunity to help offset the loss of competition resulting from the mergers. Three and Vodafone have also argued that the merger would stimulate competition and choice at the wholesale level. With 90% of MVNOs currently hosted by BT/EE and Virgin Media O2, the capacity uplift from the deal would provide an incentive to fill the network with traffic, which would mean pricing access competitively.

On the second point, it is understood that no credible remedy taker has come forward to discuss with the CMA about obtaining better terms or securing network access to enter the market. It can probably be discounted that Tesco Mobile, a 50:50 JV between Tesco and Virgin Media O2, would switch to the merged entity. Sky Mobile, which represents an important competitive constraint given its strong position in the fixed and content markets, and its range of multi-play offerings, has also not expressed interest in a wholesale remedy – nor in something structural that would enable a transition from a 'full MVNO' to a mobile network operator in its own right.

Given the ongoing cost of living crisis in the UK, the potential for higher consumer bills that a reduction in the number of competitors could bring about has been a contentious issue during the merger review, particularly in its early stages. At a Business and Trade Committee hearing in October 2023, the effect of the deal on prices took centre stage, with several references to the impacts seen in Australia following a similar combination. Unite the Union, for example,

warned that the Three/Vodafone transaction would raise average bills by up to £300 per year. The CMA's analysis of the Gross Upwards Pricing Pressure Index (GUPPI) suggests increases of between 5-10% and 10-20% for Three, and between 0-5% and 5-10% for Vodafone. Its merger simulation predicts that the merged entity's prices would rise by 7.0% for Three and 3.8% for Vodafone on average. While the GUPPI analysis points to a harm to customers in the UK worth at least £328m per year, based on the number of mobile connections, this equates to an annual individual impact of less than £3.70 – or 31p per month. Stephen Lerner (General Counsel and Regulatory Affairs Director, Three) stated publicly that price rises are not planned and were not part of the transaction rationale. It appears that the CMA does not feel the need to attach a strict pricing condition (which can be onerous to operate and monitor, and may not address the causes of an SLC), instead consulting on temporary protections on existing customers' contracts and on social tariffs. This is more proportionate in light of the evidence presented, with the UK telecoms market already shown to provide good value for money relative to its peers. Time-limited measures arguably also reflect continued commitments to protecting vulnerable end users through voluntary social tariffs, while also providing a stop-gap solution until the benefits of greater competition and investment materialise.

With it unusual for the CMA to change its mind between provisional findings and a final decision, a pathway to approval in December exists

The CMA has now set out how the merger could potentially harm competition but crucially how it considers the parties might mitigate the risk of that occurring. The CMA tends not to favour behavioural remedies, preferring structural remedies, such as divestiture (or prohibition), which it considers are generally more likely to deal with an SLC and its resulting adverse effects. The remedies on which the CMA is consulting would carry risk, in particular regarding monitoring, enforcement and circumvention. The onus will be on the merged entity not only to make the requisite investment but also to be prepared to be transparent about how it is driving uplifts in network quality or contributing to the Government's standalone 5G ambitions, for example. This will also give Ofcom a role in enforcement efforts, specifically in terms of monitoring – in an as ongoing and agile way as possible – how the merged entity is fulfilling its investment commitment. That said, the fact that the CMA considers that a structural remedy would not be suitable for Three/Vodafone and that the SLCs would be best addressed through behavioural commitments is noteworthy. After O2 and Three's failed attempt at consolidation in the UK, the climate this time around feels less hostile, presenting a much better chance of getting a deal through.

The notice of proposed remedies bears this out, with the CMA outlining a pathway to approval based on a series of behavioural commitments. The end-to-end review process has involved a lengthy 'pre-notification' period, formal notification of the transaction by CKHGT and Vodafone Group, invitations to comment and an official Phase 1 merger inquiry that gave way to the ongoing Phase 2 review. In-depth scrutiny was warranted but the merger has not been prohibited outright, and it is positive that it has reached this stage.

Consultation on remedies closes on 27 September, while comments on the provisional findings can be submitted until 4 October. The CMA will be eagerly awaiting stakeholder responses and may consider further hearings specifically on commitments, but it is unlikely to change tack now, with final approval poised to be granted on 7 December – if not sooner. Notwithstanding the possible negative impacts of the merger, the CMA has clearly taken a balanced approach that offers a workable way forward for the parties. This gives them the opportunity to see through the promised benefits of the deal, including improved quality for consumers, productivity gains, more intense wholesale competition and greater investment in the UK's mobile networks.

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