SUBMISSION TO DG COMPETITION FROM THE FCS REGARDING THE PROPOSED MERGER BETWEEN Hutchison (Three) and Telefonica (O2)

This paper is a submission from FCS, the UK trade body for businesses which deliver professional voice and data communications solutions to business and public sector customers in the UK. It has been prepared in consultation with IMVNOx, the global trade association for mobile virtual network operators (MVNOs).

We wish to ensure that we reflect the views of wholesale service providers, B2B CPs and their partners in the UK as well as UK based MVNOs.

UK MARKET BACKGROUND

In the UK market, the Competition and Markets Authority is already proceeding with a Phase 2 investigation into the proposed merger of BT Group, who have SMP in copper and fibre network infrastructure with Everything Everywhere, who own Europe's largest 4G network and are the UK's largest Mobile Network Operator. In this context, the proposed acquisition of O2 from Telefonica by H3G represents a further significant consolidation in a market which already fails to offer competitive third party access at the wholesale level.

We believe the two mergers cannot be considered in isolation. Because their effects on the UK market will not be felt in isolation. And we urge DG Competition to consult in depth with the UK Competition and Markets Authority and with the UK Regulator, Ofcom, so your counsels are fully informed by the detailed considerations which have already taken place concerning the current and future state of the UK market.

To help set this context, we summarise the UK wholesale/resale industry's concerns about the effects of BT/EE and Hutchison/Telefonica below:

BT/EE and Three/O2 merger issues: summary of CP and MNVO concerns.

The FCS and IMVNOx are concerned that the new entities created would be overly dominant to the detriment of others in the market. We believe that the mergers would reduce competition for other industry players and for consumers.

The proposed new BT/EE entity will operate across two different markets: fixed line which has been closely controlled and regulated by Ofcom, and mobile which has traditionally experienced lighter touch regulation in order to encourage market entry and investment. Regulation of fixed line services, together with the Undertakings provided by BT Group a decade ago (provided to avoid a referral by Ofcom of the wider market to the Competition Authorities), has helped to ensure that that regulated wholesale products are available on an "equivalence of inputs" basis for new entrants and service- only providers. Where those products are available, for example for fixed-line telephony over copper access networks, the retail services can be economically provided by a range of service providers and indeed many hundreds of service providers exist.

There is no equivalent regulated wholesale access in the mobile markets. Companies who wish to provide mobile communications services but who are not one of the main mobile network operators (MNOs) can become MVNOs through commercial negotiation for network access and associated services with the MNOs.

A combined BT/EE is likely to be able to use its cross-market position to its advantage in a way that other operators cannot. BT would, via this transaction, buy its way into the mobile market. Other fixed line operators do not have the ability to do the same and therefore this merger would adversely affect them, particularly if provision of stand-alone fixed services becomes unviable.

It should be noted that BT is currently a player in the mobile market, through its MVNO, and EE is a player in the residential fixed line market. A merger would therefore eliminate these competitors from each market place. Ofcom designed the 2012 'digital dividend' spectrum auction with the specific intention of encouraging an additional player into the market by ring fencing one block of spectrum for a new entrant, yet now the level of competition is likely to reduce as a result of this merger.

Market dynamics: service offerings

We are moving into a converged world where apps and data are becoming increasingly important; even voice is now a data output thanks to the growth of Voice over Internet Protocol (VoIP) calling. It is easy for these mergers to become a discussion about voice: voice is the legacy position, and voice is how the present regulatory framework grew up. But the future (and indeed the present) is not voice, but data. Data volumes are growing every day, while voice minutes continue to decline. Data can be delivered effectively and price-efficiently over either platform.

So we have a growing demand for connectivity which can be delivered either over a price-regulated wholesale equivalence fixed line platform or a non-regulated monopoly mobile platform where a handful of players control not only price and terms of wholesale access, but whether there is even any wholesale access at all.

As IP becomes all-prevailing in providing both voice and data services to enable a competitive and innovative market that offers UK plc the best choice of application and service, service providers must have equal access to the mobile market in the way they already have within the IP Softswitch Market.

Without this equal access the big three MNOs will have a massively unfair advantage in being able to provide bundled mobile and IP services. It has already been seen that the big MNOs are not good at innovation; they try and protect revenues by providing service that benefit their bottom line at the expense of innovation and customer benefit. One example is the cost of sending a picture message - using the MNO offers, consumers will be paying 35p per message, this compares to an over the top applications like What's App that provide this service at almost zero cost.

We need to make sure this opportunity to innovate at all levels in the Mobile market is available to all as ultimately this benefits UK plc

Summary of concerns with the proposed mergers

Any reduction in competition between MNOs is likely to lead to change in behavior towards the MVNO operators, leading to worsening treatment of such MVNOs as exist and reducing the ability of any new ones to become established and thrive

Increasing market concentration reduces consumer choice.

Inability of industry resellers to access competitive wholesale products stifles disruptive market innovations and concentrates power in the hands of the MNOs.

Experience in other countries

In countries where there are a limited number of players, the result on the consumer is lack of service choice and high prices. For example, in the UAE market, the limited number of incumbents and the restrictions in MVNO launches and regulatory stickiness in pricing means that prices are kept high and segmented offerings are limited. A further example where pricing and service development could be improved is Turkey: whilst MVNOs are accepted, the double taxation burden on MVNOs means launching MVNOs is not economically viable, hence limiting the competition possibilities.

Globally, open MVNO access is seen as a way of stimulating competition, such as in Mexico where plans are being made to develop an open access wholesale platform to allow new entrants into market, which is dominated by one main incumbent.

It is too early to fully see the result of moving from four operators to three in Germany and Ireland last year, but in Austria which made a similar move in 2013, prices have gone up for consumers.

Specific concerns about the proposed O2/Three merger

1: Reduction in competition. H3G was brought into the mobile market to help shake it up and encourage competition. The number of operators was expected to increase to five when BT acquired mobile spectrum. Now that number looks likely to reduce to three MNOs if the O2/Three merger proceeds. This could easily lead to a path of viable acquisitions that would give all three operators quad play abilities, leaving little room for competition.

2: Access to mobile network. With network sharing agreements in place between EE and Three, and Vodafone and O2, a merger between Three and O2 would create asymmetry by giving the new entity access to the entirety of the UK's mobile network, giving a structural advantage that others could not match.

The possibility of this underlines the need for greater separation between infrastructure ownership and service provision. The proposed merger should not be permitted to take place without such a separation as a condition.

Possible Remedies

As a condition of either the BT/EE or O2/Three mergers proceeding we suggest that there must be an undertaking on both Groups to provide an open, transparent and equivalent wholesale offer which would allow Communications Providers of all sizes to compete on a level playing field and allow sustainable and effective competition in service provision.

As part of this requirement we also request that an obligation should be placed on both merged groups to provide National Roaming within 24 months of these agreements being in place. (At this stage Vodafone, the UK's remaining MNO, would be excluded from this obligation. But by forcing 75% of the mobile market into national roaming, we suggest market forces would encourage Vodafone to participate, otherwise their network coverage could be seen as limited compared to the other two operators.)

In order to give confidence and help resolve other issues of transparency and sustainability, this should be accompanied by a form of separation between the network infrastructure and service activities of the mobile network operators.

We would advocate separation of the mobile physical infrastructure from the retail provision to ensure that true competition can be maintained. This would allow for the creation of a BSS/OSS platform as outlined above.

Conclusion

We believe the impact of the proposed merger of Hutchison and Telefonica on the UK market can not be properly considered outside the context of the proposed BT/EE merger currently under investigation by the CMA.

We believe there are good grounds to expect a merger between O2 and Three to have major impacts on the market. Additionally these impacts will work generally to the constraint of competition and to the detriment of an open, transparent and competitive communications market.