Communications Consumer Panel and ACOD comments to the European Commission in relation to the proposed merger between H3G and O2

Introduction

The Communications Consumer Panel and the Advisory Committee for Older and Disabled People (ACOD) welcome the opportunity to comment on the proposed merger between H3G and O2.

The Panel works to protect and promote people's interests in the communications sector. We are an independent body set up under the Communications Act 2003. The Panel carries out research, provides advice and encourages Ofcom, governments, the EU, industry and others to look at issues through the eyes of consumers, citizens and microbusinesses. The Panel pays particular attention to the needs of older people and people with disabilities, the needs of people in rural areas and people on low incomes, and the needs of micro businesses, which have many of the same problems as individual consumers. There are four members of the Panel who represent the interests of consumers in England, Northern Ireland, Scotland and Wales respectively. They liaise with the key stakeholders in the Nations to understand the perspectives of consumers in all parts of the UK and input these to the Panel's consideration of issues.

There is also cross-membership with Ofcom's Advisory Committee on Older and Disabled People. This means that Members, in their ACOD capacity, provide advice to Ofcom on issues relating to older and disabled people including television, radio and other content or services regulated by Ofcom as well as about issues concerning the postal sector.

Response

The Panel's comments are as follows:

- Prior to the merger between T-Mobile and Orange in 2010 to create EE, the UK had five major mobile network operators (MNOs). Following that merger, and given the Competition and Markets Authority's clearance of BT's takeover of EE, there is now a risk of even fewer providers offering services to consumers, with a possibility of just three MNOs. We do not believe such a reduction in competition and choice best serves consumers. The consumer should be at the heart of a competitive market. It is therefore vital that the potential impact of the proposed merger on the consumer is made a top priority.

- H3G and O2 are proposing to merge their businesses in the UK. Although this will reduce the number of MNOs in the UK from four to three (with an unarguable concurrent reduction in consumer choice), both players argue that this will not result in a material reduction in competition, and that the cost synergies released from the deal will allow the combined entity to increase its investment for the benefit of consumers. The Panel remains unconvinced by these arguments, and finds it hard to envisage any circumstances in which this deal could be good for consumers in either the short or long term. We cannot see how less competition supports the aim of a competitive market that works for consumers. There are also some features of the current network sharing arrangements in the UK that create further significant concerns about this deal, should it proceed.

- When two MNOs merge, cost synergies are available. These can improve efficiency and will normally flow through to lower consumer prices. The dominating efficiency normally comes from combining networks, followed by a much lower benefit from combining retail stores in similar locations. With respect to the former, in the case of 3 and O2, we do not see that this benefit is readily available. The UK market has already squeezed these multi-network efficiencies out with two sets of substantial network sharing agreements, and therefore there is not a real opportunity to combine the 3 and O2 networks - indeed there are significant competition concerns arising from the potential participation of the combined entity in the two remaining network shares (see below). There might be some savings available from retail store consolidation, but these will also reflect on the risk of reduced overall retail competition (see below). Our conclusion is that only minimal cost synergies are available which won't result in lower retail competition.

- The Panel can see no positive outcomes for consumers if O2 and 3 combine brands and distribution as they are likely to do to achieve further costs synergies. 3 remains a challenger brand in the UK, driving down prices and pushing pricing structures to benefit consumers. In a combined entity, with a significant joint market share, we can see no logical reason why this strategy would be continued, nor that the combined costs of maintaining two brands makes sense. This can only reduce competitive pressure in the market leading to higher prices and less innovation, to the disadvantage of consumers.

- We are conscious of the network sharing agreements that the MNOs have already undertaken. We would encourage the Commission to fully examine the implications of these arrangements and the potential impact of any mergers on consumers and citizens – from not only a financial perspective but also considering the effect on mobile voice and data coverage available to consumers. The UK has a problem with partial "not spots". We would be anxious to avoid any unintended consequences that might result in this being exacerbated in any of the nations.

- We are entirely unconvinced that any synergies achieved will be redirected into investments. Commercial investment decisions are driven not by what 'extra' profit is available to invest, but by what minimum investment is required to achieve the optimal return on investment. Firms invest because they are under competitive pressure to improve their service for customers (when their market share is under attack, or when they need or wish to grow share), not because they are 'profitable enough' to afford the investment.

- Additionally, if this merger proceeds we see potentially dangerous consequences for consumers from the impact on network sharing. Today the UK has effectively two competing physical network infrastructures - Vodafone/O2 (Beacon) and EE/3 (MBNL). If the merger proceeds then there are a limited number of network outcomes, all of which are negative:

  1) O2/3 remains active in both physical networks, has the best combined coverage, and a positive incentive to prevent further investment in either infrastructure, so maintaining its dominant differentiated position.

  2) 3 exits the EE/3 infrastructure, and focusses on the Vodafone/O2 infrastructure. A potentially better outcome, but this still leaves an imbalance between Vodafone/O2/3 versus EE alone.

  3) O2 exits Vodafone/O2, leaving Vodafone alone versus O2/3/EE together. This would have the effect of making Vodafone a weak network and reduces any competitive pressure for development of the larger network.

  Practically, an exit of O2 from Vodafone or of 3 from the EE network share would be legally, commercially and technically very difficult. The only certainty would be that the focus yet again shifts from building great networks for customers back to internal technical and commercial reorganisation. These complexities are likely to drive O2/3 to suggest that they must remain in both networks. This is highly unattractive for the reasons outlined above.

- We are aware that consumers have experienced significant price increases in some other European markets where there has been a reduction in the number of MNOs in the market. This is of significant concern to us. As part of the examination and assessment of this merger proposal we would encourage a detailed and thorough exploration of what safeguards might be necessary to protect consumers and whether they could be workable and sufficient; and an acknowledgement that the assessment of any such price increases should be made according to the range and price of tariffs available in the marketplace – not just the price per unit. (For example, price per Mb, which may appear to fall in relative terms but may only be offered in amounts that are more than a consumer may require, forcing them to pay for more than they need.)

- We would urge that full consideration be given to the implications of such a merger on the needs of different constituencies of consumer, including older or disabled people. We would also encourage the full consideration of the needs of microbusinesses, which often behave in the market in the same way as individual consumers and have a limited choice of services in the market.

- If there is less differentiation between providers as a result of the proposed merger, there is a risk of there being less impetus to improve customer service. Customer service and complaints handling are already problematic within the telecommunications sector so we are concerned about any developments that might militate against improvements.

- We have some concern that the proposed merger might lead to greater tie-ins or hard to exit contracts; deals could become more complex and harder to change/exit, thus further stifling consumer engagement and switching. If competition is to drive improvements for consumers then a reduction in competition and consumer choice requires some other mechanism to keep providers on their toes – improving the ease of switching and greater rights to cancel contracts could be that mechanism.

- To ensure that consumers' interests remain central to the operation of a successful competitive market, this anticipated merger cannot be viewed in isolation. We would therefore urge the Commission to take a holistic view of the market and its consumers and to work closely with the CMA so that this transaction can be fully considered in the light of the BT/EE acquisition. The implications of both, we believe, need to be analysed comprehensively as part of the same process.

Summary

In summary, the Panel is concerned that the position of all UK telecommunications consumers is not weakened in any way by the anticipated merger. The execution of this deal after the physical network sharing deals of the last decade means that there are very few legitimate cost efficiencies available that are beneficial for consumers. There is a danger that such mergers could be driven by a desire to reduce the competitive intensity of the UK mobile market, to allow prices and margins to rise for the benefit of operators and at the cost to consumers. In our view, beyond benefitting the companies involved – which should not alone be grounds for approving the deal, we have yet to see any credible reasons why this merger should be allowed to proceed.