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Consolidation and reconfiguration in the UK mobile sector

Richard Eccles and **Colin Long**, respectively partner and Of Counsel at **Bird & Bird**, *examine the likelihood that remedies applied to mergers such as Three/O2 in the UK could centre around exisiting network sharing agreements, as well as transferring network capacity to MVNOs.*

The European Commission (EC) will probably soon be faced with another significant merger of mobile operators, this time in the UK. H3G's proposed acquisition of Telefonica UK will likely pass the Community dimension thresholds, requiring notification to and approval by the EC. Indeed, H3G's acquisitions of Orange Austria in 2012 and of Telefonica Ireland in 2014 have both required such approval.

The EC last examined a UK mobile sector merger in 2010, when it cleared the joint venture of Orange UK and T-Mobile UK without a second phase investigation. The clearance was subject to remedial divestment obligations to deal with a concentration of spectrum holdings that could be used for 4G (LTE) services (in the 1800 MHZ range), together with an obligation on the merged group to enter into a revised network sharing agreement with H3G. However, the EC stated that the market featured strong competition including a significant number of MVNOs, and that MNOs would not have an incentive to foreclose MVNOs, as they would lose more than they would gain in terms of wholesale revenue, if the MVNOs left the market.

It will be interesting to see whether the EC's assessment of competition from MVNOs will have changed and how it might apply its analysis this time, in the light of its more recent merger control decisions in the mobile sector. These decisions appear to have established a framework of requiring disposals of network capacity, and possibly spectrum, in favour of MVNOs, as remedial measures for four to three mergers.

Effectively, there are only two UK mobile network infrastructures, because network sharing arrangements are in place between EE and H3G and between Vodafone and Telefonica UK. EE and H3G's arrangement pre-dates the 2010 Orange/T-Mobile merger and the remedies then required by the EC, while the Vodafone/O2 network sharing agreement dates from 2012. Now that one party to each of the network sharing agreements, H3G and Telefonica, are planning to merge, the EC will presumably need to assess whether future network sharing arrangements will contribute to, limit or support competition.

Meanwhile, BT is planning to acquire EE, a transaction which will reportedly not satisfy the Community dimension thresholds due to BT's UK business focus, and instead be examined at national level by the Competition and Markets Authority (CMA). Indeed, the CMA has already issued a preliminary invitation to comment (by 18th March 2015).

The UK may request the EC to refer H3G/Telefonica UK to the UK authorities after the merger has been notified to the EC. This would have to be on the basis that the merger concerns a distinct national market. However, it is a different matter whether the EC would agree to a referral. On the assumption that separate authorities will assess each merger, possibly in parallel, it remains to be seen to what extent the EC will assess EE as likely to be strengthened by its merger with BT.

The UK market position

When the EC assessed Orange UK/T-Mobile UK in 2010, it concluded that the UK market for retail mobile services was competitive and likely to remain competitive following the transaction, taking into account the market structure and characteristics. The EC found that the merger would not trigger competition concerns in wholesale or retail mobile markets, but was concerned that the parties' combined holdings of spectrum at the 1800 MHz level could result in the merged entity being the only UK MNO initially able to offer full speed national 4G mobile data services. Accordingly, the parties agreed to some significant 1800 MHz spectrum divestments.

More recently, some indication of market shares by spectrum capacity (as opposed to subscriptions or revenue) can be seen from data produced by Ofcom in 2012 (in its Assessment of future competition and award of 800MHz and 2.6GHz, July 2012) in preparation for the subsequent 4G auction. Ofcom concluded that consumers were likely to benefit from better services at lower prices if there continued to be at least four 'credible' mobile operators. As such, Ofcom concluded that very asymmetric spectrum holdings should be avoided, and decided to reserve some spectrum for H3G (as the smallest operator) or a new entrant. In the event H3G did acquire sufficient spectrum in the auction. Ofcom also imposed a limit on the spectrum that each operator could acquire, to 310 MHz or 37% of total holdings. The current holdings of the various operators are shown in the chart below.

The chart shows that a combination of H3G and Telefonica's spectrum would afford the merged group only 27% of the total capacity, less than either EE or Vodafone.

The current spectrum holdings of the UK's mobile operators

MHz band	800	900	1800	2100	2600	Total	%
EE	2x5	-	2x45	2x20	2x35	210	36%
H3G	2x5	-	2x15	2x14.6	-	69.2	12%
Telefonica	2x10	2x17.4	2x5.8	2x10	-	86.4	15%
Vodafone	2x10	2x17.4	2x5.8	2x14.8	2x20, 1x25	161	28%
BT	-	-	-	-	2x15, 1x20	50	9%
Total	60	69.6	143.2	118.8	185	576.6	100%

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Competition issues regarding network capacity and spectrum

The EC may consider that the H3G/Telefonica UK merger will result in the loss of an important retail competitor, notwithstanding the various MVNOs. It will inevitably focus on the fact that at wholesale level, there would be a reduction of MNOs from four to three.

The EC has cleared three recent mobile sector mergers, all four to three transactions, at the relatively high price of commitments to dispose of significant amounts of network capacity, and also spectrum, in order to facilitate the entry (or expansion) of MVNO competitors to counter-balance the increased market power of the merged entity.

In the three most recent cases, Telefonica Germany/EPlus, H3G/Telefonica Ireland and H3G/Orange Austria, the EC has accepted remedies involving a transfer of resources to MVNOs, to enable them to compete more strongly.

In Telefonica Germany/E-Plus and H3G/Telefonica Ireland, the acquirer agreed to divest up to 30% of the merged entity's network bandwidth capacity to MVNOs, at fixed payments.

In H3G/Orange Austria, H3G committed to provide wholesale access to its network as regards 30% of its capacity, to up to 16 MVNOs in the coming ten years. In each of these cases, the acquirer also committed to divest some spectrum and sometimes some additional rights or assets.

The remedy adopted in the most recent cases, H3G/Telefonica Ireland and Telefonica Germany/E-Plus, of requiring a long term divestment of network capacity as opposed to spectrum, was a ground-breaking form of commitment. The capacity provided a stable basis for the beneficiary MVNOs to run a flexibly priced competing retail operation.

Based on its approach in these recent cases, it is likely that the EC will want to ensure the protection of competition from existing MVNOs that use Telefonica UK's network, and possibly also to facilitate additional or stronger competition from the MVNOs by compelling a release of network capacity to them.

It is also possible that, in assessing H3G/Telefonica UK, the EC will review the outcome of the remedies imposed on H3G's two previous acquisitions, of Orange Austria and Telefonica Ireland, in order to assess the appropriateness of proposed remedies in the present case. In this regard, it has recently been reported that, in Austria, H3G's retail prices have risen by approximately 40% for some mobile services since H3G's acquisition of Orange Austria, albeit that such price rises were halted by price competition from MVNOs in the low-end segment.

Competition issues regarding network sharing

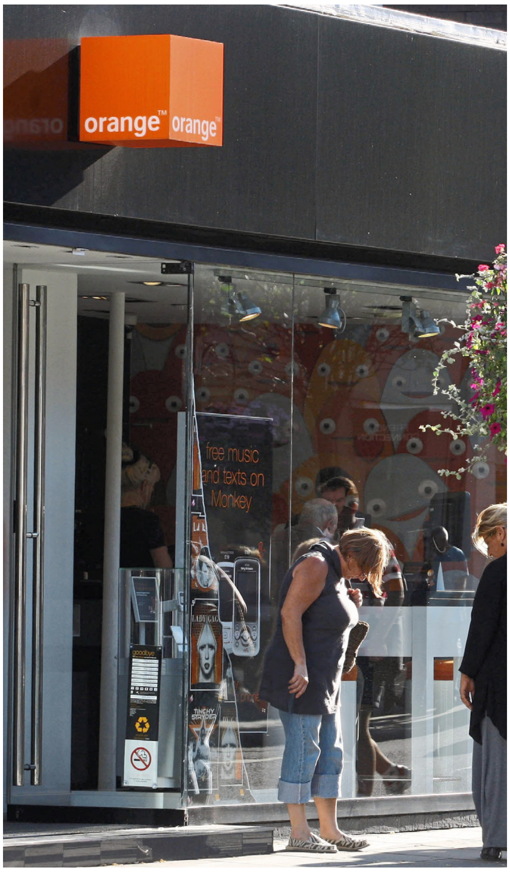
As in previous mobile sector merger control decisions, the EC may seek commitments from the merging parties to maintain a network sharing agreement with a third party operator, and to strengthen the terms of such arrangement for the benefit of that other operator. In the present case, however, the EC may consider the possibility of seeking a termination of one of the current network sharing agreements in the UK, in order to avoid the present acquirer, H3G, gaining control not only of Telefonica's network but also gaining a degree of indirect influence or an interest in Vodafone's network through the Vodafone/Telefonica network sharing agreement, given H3G's network sharing agreement with EE.

In the H3G/Telefonica Ireland and Orange UK/T-Mobile UK cases, the EC was concerned to ensure continuation of a party's network sharing agreement with a third party in order to secure that third party's position as a competitive force on the market.

In H3G/Telefonica Ireland, the EC was concerned about Telefonica's/O2 Ireland's network sharing agreement with Eircom, and H3G committed to continue this agreement on improved terms. This ensured that Eircom remained an effective and viable competitor, as Eircom needed the agreement to achieve its network roll-out plans.

In Orange UK/T-Mobile UK, the EC's assessment that the market would remain competitive post-transaction, was subject to its analysis of the effects on T-Mobile's network sharing agreement with H3G.

The EC identified serious concerns that the parties would have the ability and incentive to erode the 3G radio access network ("RAN") sharing agreement so as potentially to eliminate H3G as a competitive force in the UK mobile market. To deal with these concerns, the parties committed to modifying and amending the 3G RAN sharing agreement and the 2G national roaming agreement between T-Mobile and H3G. The network sharing arrangement between EE (post-merger) and H3G was formally established as a joint venture, Mobile Broadband Network Limited, which managed the sharing of the base stations, antennae and other equipment in the shared 3G network. In February 2014, a 4G network-sharing agreement between EE and H3G was announced. In contrast to the parties' "active" 3G network sharing agreement, the 4G arrangement between EE and H3G is reportedly a passive network sharing agreement where mast infrastructure and backhaul transmission costs, but not the equipment, are shared, the two operators



having separate antennae, spectrum and core networks, so that each of them is apparently able to roll out its equipment at its own pace.

In 2012, Telefonica UK and Vodafone UK launched a network sharing agreement to pool the basic parts of their network infrastructure to create a single national grid, running each operator's 2G and 3G spectrum. This was also intended to enable an accelerated roll-out of the two operators' 4G networks. The Office of Fair Trading (OFT) treated the network sharing agreement between Vodafone and Telefonica as a merger for purposes of the UK merger control rules, as regards the passive network aspects, whereby the parties shared the physical structures, including masts, towers, power supplies and cabling, to which the active assets (transmission equipment) would be fixed. (However, the OFT concluded there was no need for a second phase merger investigation by the Competition Commission.) The OFT did not regard the sharing of active assets to involve a merger, because there was no sharing of pre-existing RAN equipment but rather the joint purchasing of new, multi-operator RAN equipment.

The fact that the OFT found there to be a relevant merger situation as regards the sharing of passive assets demonstrates the closeness of integration between the parties to such a network sharing agreement.

The network sharing agreements will have been driven originally by the need for cost-sharing and efficiency in the roll-out of

The last mobile sector merger in the United Kingdom to be approved by the EC was Orange/T-Mobile UK in 2010

the respective 3G and 4G networks. In the context of the prospective H3G/Telefonica UK merger, the main concern is likely to be to ensure rationalisation from a competition prospective of the two network sharing arrangements following a merger of one party to each such arrangement. It may or may not be the case that H3G's own rationalisation objectives in this regard would accord with the EC's competition assessment of the appropriate solution.

A further consideration is whether either party is entitled under the network sharing contracts to terminate such agreement, whether or not this were to be the focus of any commitment required by the EC. Moreover, significant early termination charges might be payable if there is a break clause.

It is possible that Vodafone may have a right of termination of its network sharing agreement with Telefonica on a change of control of Telefonica UK, but it is also likely that Vodafone will, by contrast, want to ensure the continuation of its network sharing agreement and that it may make representations to the EC in this respect. Previous cases in which the EC has required the termination of an agreement or a surrender of contractual rights as a remedy, have concerned situations where the relevant merging party had a right of termination, or was merely required unilaterally to waive certain rights, or where the other party to the relevant agreement had itself agreed to exercise rights of termination as a result of the merger. It is doubtful whether the EC could insist on a commitment by a merging party to terminate an agreement with a third party if the merging party did not have the contractual right to do so and if the other party to the agreement in question did not itself wish to terminate the agreement.

> "It is also open to question whether the EC could compel a termination of such an agreement if the relevant third party, the other party to the relevant network sharing agreement, did not wish to do so, and if the relevant merging party did not have the unilateral contractual right to do so"

Conclusion

H3G's acquisition of Telefonica UK would be a 4 to 3 merger of MNOs in the UK mobile sector, where each of the merging parties is in a network sharing arrangement with one of the other MNOs. Moreover, one such network sharing arrangement was itself held to be a merger of the passive network elements, for purposes of the UK merger control rules. Many four to three mergers could be prohibited altogether where it is not possible to structure appropriate remedies, as in the case, for example, of UPS's intended acquisition of TNT Express, which the EC prohibited in 2013.

The various EC decisions in mobile sector merger control cases in recent years show a framework by which clearance may be possible, but at a relatively high price of disposal of network capacity and also sometimes of spectrum. Any such remedy in the present case could focus on a transfer of network capacity, most likely in favour of MVNOs, who could as a result gain a much stronger position. This capacity might be required to be provided on fixed payment terms, which would give greater stability and pricing flexibility in the conduct of the MVNO businesses, possibly enabling them to price their services more competitively. It is therefore possible that in the present context of a four to three merger, the EC may make a fresh assessment of a need to reinforce the position of MVNOs to counter-balance the increased strength of the merging MNOs, in contrast to the position which it took on MVNOs in the context of the Orange UK/T-Mobile UK merger.

It is also likely that any remedies package to enable clearance of the merger will need to resolve the network sharing arrangements between Vodafone and Telefonica UK and between EE and H3G. The EC may seek to avoid all of the leading MVNOs' networks becoming inter-related as a result of one party to each such network sharing arrangement merging with the other.

It is open to question whether any solution which may be preferred by the EC would coincide with the merging parties' and in particular H3G's preferred means of rationalising the merged group's network arrangements. It is also open to question whether the EC could compel a termination of such an agreement if the relevant third party, the other party to the relevant network sharing agreement, did not wish to do so, and if the relevant merging party did not have the unilateral contractual right to do so.