House of Commons

Business and Trade Committee

Oral evidence: Three-Vodafone merger: implications for competition, HC 1869

Tuesday 17 October 2023

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Watch the meeting

Members present: Mark Pawsey (Chair); Douglas Chapman; Antony Higginbotham; Ian Lavery; Anthony Mangnall; Andy McDonald.

Questions 1-42

Witnesses

I: David Hennessy, Chief Technical Officer, Three; Stephen Lerner, General Counsel and Regulatory Affairs Director, Three; Andrea Donà, Network and Development Director, Vodafone UK; and Nicki Lyons, Corporate Affairs and Sustainability Director, Vodafone UK.

Examination of witnesses

Witnesses: David Hennessy, Stephen Lerner, Andrea Donà and Nicki Lyons.

Q1 **Chair:** Welcome to this session of the Business and Trade Select Committee. We are looking at the proposed merger between Three UK and Vodafone and focusing on the implications for competition in the market.

We are joined today by Nicki Lyons, corporate affairs and sustainability director at Vodafone; David Hennessy, chief technical officer at Three; Stephen Lerner, general counsel and regulatory affairs director at Three; and Andrea Donà, network and development director at Vodafone UK. I will start by asking each of the witnesses in turn to tell us about the commercial merits of the proposed merger between Three and Vodafone, and perhaps any of the risks that might exist.

Nicki Lyons: Good morning, everyone. We are confident that this merger will bring benefits to the country, to competition and to consumers as well. We have done a lot of work looking at the investment potential. We have committed to invest more than £11 billion into the new merged entity, which will enable us to deliver our commitment to the Government to support the wireless infrastructure strategy and bring 5G to the whole of the UK. We believe that will have significant benefits to consumers and to competition in the sector.

Chair: And the risks?

Nicki Lyons: There are actually significant risks for us in not being able to merge. We think that the sector is in significant need of investment. We are challenged every day by the costs of running a network in the UK—things like annual licence fees and energy costs. For us, this deal makes sense. This will bring significant benefit.

Chair: Andrea Donà, also from Vodafone, do you have anything to add to what Nicki Lyons has told us?

Andrea Donà: Yes. Good morning, everyone. The scale that this merger will give the two companies will allow us to expand our network into the rural areas, removing about 25% of the notspot areas, the areas that currently are not served by any of the operators. That will enable us to expand our 4G coverage to up to 95% in geographical coverage by 2034, unlocking the economic value of £150 million as per the Government's analysis on the benefit that the 5G will bring to the economy. By reinvesting £11 billion into the network—£6 billion in the first five years—we will bring 5G stand-alone, which is the new, true 5G, to the hard-to-reach areas of the UK where currently it is uneconomical for us to invest. That will bring coverage to about 85% of UK households by 2034 and it will also bring 5G connectivity to the rural areas, bridging the rural divide that they were suffering from.

Q2 **Chair:** Thank you. Mr Lerner, from Three's point of view, what is in it for you and what is in it for consumers?

Stephen Lerner: Three is in a very difficult position. We are trapped in this vicious cycle of low scale, low returns and lack of growth. We have 13% market share. We have not grown in the last five years. We have very low returns. We are making less than 1% return on capital, well below the cost of capital, and we have an unsustainable investment level. We have a very high fixed cost base because of the nature of the market. Roughly a quarter of all the industry capital expenditure is spent by Three, yet we are cash-flow negative; 90% of all the positive cash flows in the industry are generated for BT and VMO2.

We are in a very difficult position. Absent this merger, we do not see any real ability to move forward and grow the business in a way that will break that cycle. It will lead to the situation where you have two subscale operators and two scale operators in VMO2 and BT, and that is not healthy for competition.

Q3 **Chair:** What are the risks either to consumers or to Three of this merger not taking place?

Stephen Lerner: I think I have given the view as to what the risk is to Three. The risk to consumers is that 5G will continue to lag. We will continue to lag as a country behind all the other benchmarks out there, and we just will not continue to drive the economy forward with the benefits that 5G brings to the wider economy.

Chair: Mr Hennessy, what would you like to add to Mr Lerner in respect of Three?

David Hennessy: I want to speak a little bit more about the risks of the merger not going ahead.

The UK is struggling and the telecoms infrastructure across the UK is struggling. If we look at the EU Observatory plus Ofcom information, the UK ranks 17th out of 28—EU27 plus the UK—for the 5G roll-out. If we look at the performance of the network's 5G speeds, based on data from Ookla, which is the leading benchmarking company worldwide, the UK ranks 21st out of 25 developed markets in 5G speeds. I firmly believe that that is a function of the structure of the market, where neither we nor Vodafone can invest sufficiently to build the 5G network that is needed to support the UK.

I think the biggest risk is that if this merger does not go ahead, we will stay in this place of mediocrity where we do not have a leading 5G network, where we cannot build the services that we want to build to help the economy grow and close the digital divide. I want to double down on the risks that Stephen has called out. Unless we can change the structural aspects of the market, it is very hard to fix the problems in the market.

Q4 **Chair:** Can I pick you up on the use of the word "we"? Are you referring to “we” as in the UK as a whole, or are you referring to “we” as in Three?

David Hennessy: I think both. When I said “we” I was specifically referring to us and Vodafone coming together and creating this new company, but the challenges are UK-as-a-whole challenges.

Q5 **Chair:** You said that we are 17th out of 28 in roll-out and we are behind other countries. Why is that? This is a market that has grown massively. People are spending more and more on their use of mobile telephony. Why are we in this position?

David Hennessy: The biggest challenges we have are, first, that there is very large fixed investment required to support mobile networks, so we need to invest across all elements of the infrastructure. Currently, about 90% of the free cash flow generated in the market goes to BT/EE and to VMO2, the remaining 10% is with Vodafone, and Three UK has negative cash flow. It requires a very large fixed investment and neither we nor Vodafone are generating enough cash to make that investment.

We require better infrastructure competition. Currently, we and Vodafone duplicate an awful lot of investment, which means that we both spend a lot of money in urban areas and it is not necessarily going into closing the digital divide or going into smaller areas across the country. The merger eliminates a lot of this duplicate investment and allows us to invest further and wider. We very firmly believe that if we get the go-ahead with this merger and make the investment—we are talking about £11 billion over a 10-year period—it will spur a lot of further investment into the market, too. It will force VMO2 and BT/EE to compete at an infrastructure level.

Q6 **Anthony Mangnall:** Good morning. What effect would the proposed merger have on competition in the UK telecoms market? Can we start with you, Nicki?

Nicki Lyons: We believe that the merger will enhance competition in the market. We think that our investment will, as David has just mentioned, prompt others in the market to also invest, which can only benefit those parts of the UK where our current infrastructure does not reach. Targeting the notspots—400 towns across the UK that will benefit from our investment in a 5G infrastructure, meeting, as I said, the Government’s wireless infrastructure strategy target—will all be further promoted as a consequence of us investing. We believe that that will then encourage others in the market, VMO2 and BT/EE, to invest as well.

We currently have a situation where we are not able to invest and the companies at the other end of the scale are not investing. We believe that this merger will provoke the entire sector to invest more to the benefit of all consumers and much greater competition in the sector.

Q7 **Anthony Mangnall:** I know that colleagues will want to come on to pricing and I do not want to step on their toes, but a similar deal that Vodafone and Three did in Australia led to a rise in prices and a worse service quality. That presumably is exactly the same argument that you were using over there—that it would lead to an increase in investment, an increase in competition and better value for consumers—yet the deal in Australia led to the opposite.

Nicki Lyons: Our assessment of the deal in Australia is that the assessment was done in a way to skew those numbers. David has a very strong example from Ireland that shows quite the opposite from a merger of Three and O2 in the same period. We question that assessment, and we are fully committed to keeping consumer prices as they currently are in our pricing strategy. We have made it very clear and we have said publicly that we will stick to our pricing strategy. We have no plans to change that.

Stephen Lerner: On the Australia example, the ACCC, which is the Australian version equivalent of the CMA, concluded that future-adjusted prices have fallen in Australia by over 10% since the merger. I think that the example of Australia shows that prices are better than they were prior to the merger.

Q8 **Anthony Mangnall:** To be clear, the ACCC opposed the merger and then was overruled by the federal court. This brings us on to what engagement you guys are having with the Competition and Markets Authority here. I will open it to any of you who want to answer. What is your engagement with them?

Andrea Donà: Could I add on to the competition part? As we roll out 5G beyond the urban and suburban areas and provide coverage and that capability, that inevitably allows you to bring new products and services to the market: the IoT—internet of things—devices that can connect; smart cities; smart agriculture in the rural areas. That enhances competition because the breadth of the products that you are able to bring to the market as a result of the expanded investment in areas that are hard to reach today enables you to bring an additional number of services that stimulate competition.

Q9 **Chair:** May I come back to you on that? How can it be that a market with three providers is better competition than a market with four?

Andrea Donà: If we look at the dynamics at play today, we believe it is an emerging duopoly of two players, Virgin Media O2 and BT/EE, the only two players in the market that have the scale to be able to invest in the way that the market deserves, to unlock the 5G potential we talk about. We are subscale. We have only 20%. Vodafone is 20% of the market and Three has 10% of the market. We lack the scale to be able to invest further. This deal gives us the scale to be able to challenge the two duopoly players in the market, stimulating competition. We will create a network that will be far superior to what we currently can afford and, as Nicki said, stimulate the others to follow suit and continue investment.

Nicki Lyons: The other factor related to consumer competition, which I am not sure was the case in Australia, is, of course, the presence in the

UK of virtual network operators. In the UK, the operators that provide offers to consumers, like Lebara, Tesco Mobile and Sky, do not have a network but they are providing consumers with a mobile offering. They are creating significant competition in the sector.

Q10 **Anthony Mangnall:** The Chair has stolen my question, but I was very happy for him to take it. I want to come back to this point because if we are going to use Australia as the template, the ACCC, regardless of its position now, still said that when markets end up with a smaller group of large lookalike players with stable positions, competition is muted and consumers pay more. Is that a fair analysis?

Stephen Lerner: I will say what Ofcom has said in its mobile strategy review. When it looks at our market—and the UK market is what we are talking about here—it says, "A weakened MNO may also be less able, or have less incentive, to invest as fully in its network than a larger, stronger player". Then it goes on to say, "In turn, this may weaken the incentives of rival operators to invest in improving their networks, leading to weaker competition and poorer outcomes for customers". I think that is more relevant than looking at an Australian example in a different context in a totally different market. We point to Ofcom and what the Government have been saying in their wireless infrastructure strategy.

Q11 **Anthony Mangnall:** Can you explain to us what engagement you have had between Vodafone, Three and the regulators on this proposed merger and what the key regulatory requirements are relating to the merger itself?

Stephen Lerner: Clearly we are in pre-notification discussions with the CMA, the Competition and Markets Authority, which will scrutinise the merger as an independent regulator. We are engaging fully and constructively in that process, as you would expect, and we are confident that when we get through it the CMA will see the merger and the competitive benefits and approve it.

Q12 **Anthony Mangnall:** You have dealt with competition and markets authorities across the world. In the instance of Australia, they rejected it. Are you expecting the CMA to take the same approach, and that you will have to appeal through a court?

Stephen Lerner: We are expecting the CMA to approve it. Once we make our case about the competitive benefits of this merger, our expectation is that the CMA will see that this is pro-competitive and in the interests of not only the market but customers and the wider economy.

Q13 **Anthony Mangnall:** You have mentioned a lot of numbers, a huge amount of investment. Some of us represent rural constituencies with large notspot areas. Will you be presenting a timeline to that level of investment? You say £6 billion in the first five years, £11 billion in total. Will you be sticking to a long-term timetable to deliver those investments?

Andrea Donà: Yes. We have defined a network evolution plan. I can say that from day one, if the merger were to be approved by the CMA, 7 million customers immediately will benefit from the coming together of the two companies. How is that achieved? Due to the spectrum holdings, the frequency that we own, we can use those frequencies on Three's masts and Three's frequencies can be used on our masts. That will give an immediate uplift to 7 million customers.

In concrete terms, that brings the 4G geographical coverage from the current 80%-ish to 91% in 2025, which exceeds the Government's own ambition to hit 90% by 2027. There is a clear road map to bring that 91% in 2025 to 95% by 2034. That is on 4G, the same progression and the same clear network plan we have for 5G stand-alone, true 5G. The 5G we use today is called non-stand-alone, which rests on 4G. 5G stand-alone is the one that unlocks the true potential of 5G, which gives you latency benefits and capacity benefits, two and a half times greater capacity in the network as a result of this merger.

Q14 **Andy McDonald:** Thank you for that explanation. Picking up on this business of addressing notspots and the imbalance between rural and urban, what are the consequences for you if you do not meet those targets in regulatory or other coercive terms?

Andrea Donà: Currently?

Andy McDonald: Yes. You are talking about going from 85% to 90% or 91%, and this is part of the grand scheme, effectively giving you greater clout and ability to invest to achieve better outcomes for our constituents. What I am asking you is what the consequences are for you if you do not achieve those objectives.

Andrea Donà: When Ofcom issues the licences to the operators, those come accompanied by coverage obligations.

Q15 **Andy McDonald:** Excellent—thank you very much for that.

I will return to the issue of prices. We have had quite a lot of information about what this will mean for our constituents. A study by the Balanced Economy Project and Professor Tommaso Valletti found that mobile prices would rise by £300 a year on average following your merger. We do not have to go to Australia to see how this worked through. We have seen in the Netherlands that moving from four to three MNOs saw prices rising 10% to 15%. Rewheel, the consultancy, found that fewer MNOs means higher prices. BEP estimates, using that analysis, that the Vodafone-Three merger would raise prices by 38%, and other research even larger rises. Rewheel estimates that in 2020 mobile costs on average are roughly twice as high in three-MNO countries than in four-MNO countries.

What do you say to that? What assurances can you give consumers that that is not what is laying in store for them?

Stephen Lerner: I will start by saying that the figures that are quoted from the Balanced Economy Project are certainly not ones that we recognise. It bears no resemblance to our view of the market. We think that the material pulled together is quite selective and you would find a much more mixed story in the economic studies. I know that you have economists in the next session; I am sure that you will hear different views from different economists. What we see is that in many jurisdictions prices have gone down in four to three mergers. Most recently—

Q16 **Andy McDonald:** Where have they gone down?

Stephen Lerner: The US.

Andy McDonald: The US has gone down?

Stephen Lerner: The US has gone down. That has most recently come out. They have seen a decrease in prices since the T-Mobile-Sprint merger.

David Hennessy: In Ireland we have price reductions, quality adjusted price reductions, since the Three-O2 merger in 2015.

Stephen Lerner: When we look at our merger in the UK and our joint business plan, there are no merger-related price rises in the joint business plan that we have between us. I want to make that clear. It is not part of the transaction rationale, and we are not planning any increases in prices. The reason is that it is not in the interests of the merged entity to increase prices. When we put together this network, it will have much greater capacity. We have a big incentive to fill that capacity and, if we do not price competitively, we will struggle to do so. It is important to remember that this will put together a best-in-class network that will have an incentive to get as much traffic on the network as possible.

The other thing to remember is that as an industry we have done a lot to support consumers through difficult times—the pandemic and the cost of living crisis—through social tariffs, through donating millions of gigabits of data to the National Databank and providing devices through the National Device Bank. We have an ongoing commitment in the merged entity to continue to support social tariffs and continue to support and maintain an important presence in flexible, contract-free offerings with no annual price increases. I think that as an industry we are doing well here.

Andrea Donà: There is another dynamic at play. David and Nicki explained earlier that today a consumer can go to the market and purchase their phone, their tariff, from what are called mobile virtual network operators. They rest on and depend on the mobile operators for their infrastructure and 90% of all those players today rely on two networks, VMO2 and BT/EE, because they have the scale and the economics to offer wholesale deals to the MVNOs. With our entry, we will have the scale to be able to offer additional wholesale competition, providing more choice for the MVNOs on where to go, creating more competition and more opportunities to our UK customers for their choice. There will be more competition because they can have more options on where they put their customers, on which network, because we will have the scale to do so.

Q17 **Andy McDonald:** You do not expect us post-merger, four or five years down the track, to be sitting and seeing charges doubling, as has been reported, or increasing by 38% or beyond the rate of inflation?

Nicki Lyons: Absolutely not. We committed right from the start when we announced our desire to merge and were very clear then that there will be no change to the pricing strategy that we have in place right now.

Q18 **Andy McDonald:** Do you submit your own research and evidence to the Competition and Markets Authority and Ofcom in these respects?

Nicki Lyons: Absolutely.

Andy McDonald: That forms part of the submissions?

Nicki Lyons: It does.

Q19 **Douglas Chapman:** To follow on from some of the questions on pricing, I think that we need to bottom this out much more. I was looking at other figures that suggest that price levels in European markets where there are only three MNOs are 20% higher than those where there are four, so prices go up when you reduce the competition. In addition to that, on consumer protection Which?, the consumer organisation, has said that it is opposed to the merger and that the merger will reduce choice for the consumer, raise prices and lower the quality of service.

On both those counts, what evidence can you provide us with today that the choice for consumers will improve with this merger? Does Which? have this totally wrong? Is it off the scale in its criticism?

Stephen Lerner: On retail pricing, this is not a four to three merger, so in my view that premise is wrong. This is a market that has a very well-established MVNO presence. We mentioned Tesco Mobile, Sky, Lebara, Lyca. There are lots of competitors in the retail market for pricing. In fact, the MVNO market has over 16% of market share of customers and they price very aggressively. They do not have the same network economics that we do. They essentially just piggyback off our networks, so it is very different. It is quite an aggressive, competitive market. To think of this as a four to three on the retail side is wrong. We have lots of studies from other jurisdictions—Austria, Italy, lots of different examples—which we will submit to the CMA, where we say in those four to three markets it shows that pricing has decreased.

Andrea Donà: On the point about choice, as you expand 5G in hard-to-reach areas where currently we do not have it, 5G enables you to have a wireless experience similar to the fixed fibre. Fibre is difficult to roll out in some hard-to-reach areas. We said, and there is a clear plan, that 82% of UK households will have fibre-like speeds through fixed wireless access, the wireless infrastructure that 5G gives you, enabling a consumer to either choose fibre or choose a wireless alternative. We have done a study that shows that that can bring up to a £15 reduction in the bill per month and up to £126 million per year by 2029, by simply having an alternative to what today is just fibre to the home. Every school and every hospital will also be covered by this technology by 2034.

David Hennessy: We are approaching the merger from an infrastructure perspective and an investment challenge perspective. Our belief is that there is a very vibrant retail market—the existing MNOs plus the MVNOs. We believe that that vibrancy will continue post-merger. In actual fact, it will increase post-merger, because we will have better competition in the MVNO hosting market. Currently, it is a two-player market between VMO2 and BT, whereas we will have the scale to offer better wholesale rates to MVNO players. Competition in the retail market will be enhanced through better product competition because we will be offering much better, and we will continue to be very price-competitive as well.

I do not think we can exclusively look at it as just a pricing debate. It is a debate about overall competition in the market, and we believe that it will be totally enhanced. As Andrea says, it will be enhanced into adjacent markets such as fixed broadband through the introduction of fixed wireless access services across the UK as well.

Andrea Donà: Let's put ourselves in the shoes of a consumer today, living in a particular area in the UK.

Douglas Chapman: I am trying to.

Andrea Donà: That consumer probably has limited choice today on which supplier to go to, because we are not all covering all areas. We have not had the investment to be able to cover all areas in the UK. This will enable us to do so in Northern Ireland, Scotland and rural Wales, meaning that the consumer in the future will be able to say, "I have coverage from this new entity. I have coverage from BT/EE. I have fibre. I have BT/EE and I am allowed to choose. I now finally have the option to choose who I go with." That enhances competition.

Stephen Lerner: I gave the US example, The interesting thing is that investment prior to their merger in the US market in the most recent study was $26 billion to $30 billion per annum. Post-merger it is $35 billion per annum. There has been a $5 billion to $9 billion increase in investment in the US post the T-Mobile-Sprint merger.

Q20 **Douglas Chapman:** On that point, I think Mr Mangnall raised the issue before about the Australian merger. The figures show that in Australia, with the merger between Vodafone and Three, the investment levels were down by 45%. Somebody in a boardroom either in Three or Vodafone must have made the decision to reduce that level of investment. How can we guarantee that that level of investment will not drop in the same way as it did in Australia when the same two companies merged?

Stephen Lerner: The answer is it is in our joint business plan. We have spelled it out that this is what we are going to invest. That is the submission we are making to the Competition and Markets Authority, and we will stand behind it.

Q21 **Douglas Chapman:** On the roll-out programme, we have seen, certainly in Scotland and other parts of the UK that may be more at the extremities away from London and the south-east, that things start in an HS2 way, start in London and then fan out to various other parts. What is your plan to turn that map around and invest more in Scotland, Northern Ireland and Wales, which are rural areas that are traditionally left out of the equation altogether until the very last minute? How can you change that so that places like Oban, Benbecula and Fort William get the level of service that is required?

David Hennessy: That is what it is all about.

Nicki Lyons: That is the plan.

David Hennessy: It is eliminating the duplicate investment in London. We do not both have to build networks. We can build a much more efficient network as a joint network in London and reinvest that into other areas—eliminate the duplication and reinvest into rural areas.

Q22 **Chair:** Can I follow up that point on investment into areas that do not have good coverage at the moment? The Government have a scheme called the shared rural network. I understand that there is a requirement to construct 222 masts by the end of next year, and basically the promise you are making to us here is that by getting together you will create more investment. How are you doing on getting the 222 masts that you are committed to under the shared rural network? How are you doing on getting those delivered?

Andrea Donà: We have commitments to reach certain coverage obligations by June 2024 and we are—

Chair: How are you doing?

Andrea Donà: We are on track for that.

Q23 **Chair:** How many of the 222 have already been installed?

Andrea Donà: We have about 100 of those installed.

Q24 **Chair:** When will the remainder be in place?

Andrea Donà: By June 2024.

Q25 **Chair:** You are making promises to us about the investment that will take place if this merger goes ahead. How do we know that you will deliver that if you have not yet completed the commitment that you made on the shared rural network?

Stephen Lerner: The CMA will be investigating this issue. If there are any concerns about what we are saying in our joint business plan and our commitments, we will engage fully with the CMA to give it whatever comfort it requires. It will be very interested in this part of the assessment and we will stand behind what we are saying.

Chair: What I want to look at is your delivery on the promises that you have already made.

Andrea Donà: We are on track.

Chair: You are telling us that you are on track to deliver what you said to the Government that you would deliver.

Andrea Donà: Can I add that this goes beyond that? This merger allows us to go beyond that without the need for public money. The shared rural network relies on a hefty chunk of public money to get to providing coverage to the hard-to-reach areas, in the TNS—total notspot—areas. This merger will allow us to future-proof those areas with 5G stand-alone. The shared rural network is just a 4G network.

Q26 **Chair:** Will you upgrade the shared rural network from 4G to 5G?

Andrea Donà: We will upgrade that, absolutely.

Q27 **Chair:** Is that a firm commitment that you have already made to Government?

Andrea Donà: Absolutely. Not through the shared rural network, through this merger we will—

Q28 **Chair:** You are saying that if this merger does not take place that upgrade will not happen?

Andrea Donà: No.

Stephen Lerner: A very important point to look at is what will happen if this merger does not go through. From Three UK's perspective, we cannot afford to invest in 5G to nearly the same extent. This is transformative for the Three UK network. It is many multiples of investment of what we would be able to do on our own. The level of 5G investment and the impact that that will have on the wider economy—it is so reduced from the ambition of the merged entity.

Q29 **Chair:** Can I come back to you on that? There are 60 million people in the UK. Between the mobile networks there are more than 60 million users, because some people have two. Are you seriously telling us that a country with that number of consumers, relatively small, does not have the demand to create four efficient mobile phone networks?

Nicki Lyons: Yes.

David Hennessy: Definitely. We can see it in the stats. We can see it in how the UK ranks compared with other leading nations. The market structure with four operators is not giving the outcome. It is just a point of fact.

Going back to the shared rural network, it is a very small part of the overall targeted network. We are talking about 200-odd additional sites. If you look at the existing networks across the country, they are all 18,000 to 20,000 sites, so 200 is a small part. What we are targeting here is building a network of 26,000 sites, which is radically ahead of anything that exists in the market or will exist in the market in any counterfactual. It is very difficult to imagine a situation where any individual operator would do it. We can do it because we are reinvesting synergies and efficiencies.

Chair: Mr Hennessy, I introduced shared rural networks as an example of a commitment that you had made previously, for you to demonstrate that the investment that you are telling us will take place actually will take place. A concern for us may be that you are making all these promises but you may fail to deliver.

Q30 **Antony Higginbotham:** I want to focus on the investment. Mr Lerner, you spoke about pre and post-merger in the US, the level of investment pre-merger and the level post-merger. Can we bring that into a UK context? We have spoken about £11 billion over 10 years post-merger. Where are we between Three and Vodafone pre-merger?

Stephen Lerner: Clearly, for competition reasons we do not know what Vodafone's stand-alone investment plan is, and we cannot disclose in an open forum our stand-alone investment plans. However, I can say, as I tried to say, that from a Three UK perspective this investment—and it is not just £11 billion in the first 10 years, it is £6 billion in the first five years—is transformative. It is many multiples of what we would be able to do on our own stand-alone basis. That is quite clear because if you look at our financial performance, we are paying out more money than we get. We are in negative cash flow every year. We are cutting back our investments, we are cutting back our ambition, and that will continue going forward.

To the question of four versus three, it is really two strong scale operators investing and two subscale operators who cannot keep pace, so it is a dysfunctional market structure. We are trying to create three scale operators who can all invest. Then there would be real network investment competition.

Andrea Donà: On the investment front, every year we have to make some tough decisions on where to invest, how to invest and how much to invest. For the past 11 years consecutively, BT/EE has been the best network in the UK because of the scale and investment muscle it has had. We want to be able to challenge that. If you look at why it is the best network for 11 years consecutively, it is because it has had the investment to go and put masts in rural Scotland and in Oban. We need that opportunity now to serve the country better.

Q31 **Antony Higginbotham:** I appreciate that you will not know the commercial decisions of EE, BT and VMO2, but do you have a sense of how much they are having to invest in their networks to keep ahead of the game? I am trying to understand where you are currently versus where they are.

David Hennessy: If you took a premise that operators are investing £400 million to £500 million per year into stand-alone networks, and if that were the case and we were investing about £1 billion a year, it is £1 billion into a single network. That is the big difference here. It is a concentration into a single network. Without knowing each other's future plans, I cannot say how much of the £11 billion is incremental above the stand-alone, but it is concentrated and that is the big difference here.

Andrea Donà: To add to what David said, obviously not knowing the detailed financials behind their investment, when we look at the benchmarking of the networks, which is public information and data, we see how many more sites they have—how many more 4G sites they have upgraded with 5G, because you can tell when you do the benchmarking. We can see how many more frequencies they have added to each site, and roughly in an area like London they have twice as many as we have.

Antony Higginbotham: By "we" do you mean stand-alone—

Andrea Donà: Stand-alone Vodafone compared to stand-alone BT/EE, roughly.

Q32 **Antony Higginbotham:** We have spoken a lot about this stand-alone 5G. Can you explain a bit: is that going right back to base-level infrastructure and rebuilding the network from scratch?

Andrea Donà: No. I can take a few minutes to explain. Non-stand-alone takes the existing 4G technology and builds on it; it is an evolution of it. 5G stand-alone is stand-alone, as the term implies, and still uses the same infrastructure, the same antennae, the same electronics, but the boards and the core network have been upgraded. It uses the same infrastructure, but you need to add additional electronics and additional technology to avail yourself of the inherent characteristics of 5G.

Vodafone has launched 5G stand-alone in the UK, 5G Ultra. The challenge is to bring 5G stand-alone to all. You have to build it out. You have to put the electronics in the hard-to-reach areas. You need to change the antennae in the hard-to-reach areas, and that requires capital investment.

Q33 **Antony Higginbotham:** What is the difference to the consumer in whether you have stand-alone 5G or 5G built on a 4G network?

Andrea Donà: The consumer has much more speed, much more bandwidth. With 5G stand-alone you can connect many more devices on it. Your battery life is much better. You can have a better response time when you are activating a particular function on the phone. Say you are a gamer, or say you are a farmer operating a drone and you need to have that responsiveness in the reaction. 5G stand-alone gives that. It reduces the responsiveness from above 10 milliseconds to below milliseconds.

Antony Higginbotham: Is that the latency rate?

Andrea Donà: Latency, exactly.

David Hennessy: 5G stand-alone has all these characteristics—latency speed, connection densities—and it is a service creation layer. It is a bit like Android is a creation layer for building apps. 5G stand-alone is the creation layer for building applications on networks. When we talk about smart cities or drones or cars or all these things, you have to have 5G stand-alone as that service creation layer that enables these. It is very hard to say what the applications will be, but we know that to build future applications you have to have stand-alone capability.

Q34 **Antony Higginbotham:** Post-merger, because you are investing £11 billion in this stand-alone 5G, does that then put you above where VMO2, EE, BT or—

Andrea Donà: No, our projections are that it will take us above them and, as I said earlier, it will then stimulate them to do the same.

Antony Higginbotham: It stimulates a—

Andrea Donà: It stimulates the whole ecosystem to move forward, absolutely. We can see it from the size of the network they are building. As David said, we are intending to build a 26,000-mast network. Currently, our best estimate is that BT/EE is at about the 20,000 to 21,000 mark, so it is a step increase that will force it also to have to invest to keep up with us.

Q35 **Antony Higginbotham:** On how you will fund £11 billion-worth of investment, are you proposing to take on new debt as a merged company to do that, or is that all just cash generated by the business through efficiencies?

David Hennessy: There will be shareholder debt. In the announced company there will be shareholder debt, but primarily the funding of the network comes from the efficiencies and the synergies of getting rid of the duplicate network and reinvesting that into the enhanced network.

We are talking about an implied enterprise value of about £16.5 billion, so £6 billion of debt is a fairly low level. The EBITDA within the joint venture will fund the investments.

Q36 **Antony Higginbotham:** We have spoken a lot about how a by-product of the merger is MVNOs having more competition with respect to where they put their business. How easy is it for an MVNO to change its network? Is increased competition for MVNOs an academic point?

David Hennessy: No, certainly not. We see MVNOs moving between the operators—not from a Three perspective, but Lyca Mobile recently moved from VMO2 to EE, I believe.

Andrea Donà: I can give you a recent example. Virgin Media was an MVNO before the merger with Telefónica and O2. It was an O2 customer. We then onboarded it in a short period of nine months. It stayed with us for a year and a half and decided then to leave, because of the merger, to go back to O2 and it has migrated across. Before that, it was with BT/EE. It has moved from BT/EE to O2. Then we won the contract and in nine months onboarded several million of its customers on to our network. Then, when the merger with VMO2 happened, it migrated back to the O2 network.

Q37 **Ian Lavery:** When mergers like this happen, there are normally winners and losers. The losers are mainly the loyal workers for the companies. Many of them will have worked there for many years. How many people might face unemployment as a result of this proposed merger? Will there be any compulsory redundancies if the merger takes place?

Nicki Lyons: I can answer that question. We are not in a position to give numbers at this stage. We have not worked through the level of detail. We know that while there is some duplication with head office jobs, the number of employees that we will need to create the new infrastructure that we are investing in will be significant. We believe that jobs will be created as a consequence of this merger for building the network to create and support the IT systems and for maintaining this new network, which will have far greater reach across the UK.

There is also a knock-on benefit to the country as a whole. We believe that a faster, more effective 5G network in all parts of the country will stimulate small businesses and other employment in those areas.

Stephen Lerner: We need to think about the current industry trend in this market, which is struggling. The current industry trend for telecoms operators is job losses, not gains. The long-term outlook for jobs within our companies if this merger does not go ahead is not good, because we are subscale and we cannot afford to invest and we have negative cash flow. These things will not lead to a good environment for workers anyway.

You have to look at the counterfactual. What will happen if this does not go through? Job losses have been announced across the sector. Without this merger, things are looking not great.

Q38 **Ian Lavery:** You seem to have a completely different view from Ms Lyons. Why would you have a difference of opinion? She said that there would probably be a lot of jobs down the line.

Nicki Lyons: No. If the merger goes ahead, that has the potential to create jobs. Stephen is talking about how if the merger does not go ahead, the sector is in trouble.

Q39 **Ian Lavery:** Sorry, Mr Lerner: if the merger goes ahead, will jobs be created? Or do you still say that there is a trend and there will be fewer jobs as a result of the merger?

Stephen Lerner: I am saying two things, picking up on what Nicki said as well. If the merger does not go ahead, the industry trend is job losses, not job gains. That is clear. Sorry if I was confusing when I spoke earlier.

Then, picking up on what Nicki said, if the merger goes ahead, with the huge investment we are making we think that additional jobs will be created in the wider UK economy in significant numbers. There have been some estimates out there of what 5G will create in jobs. It is quite significant. That will be beneficial. Nicki has been talking about what will happen in the two merged companies, which she may want to pick up on again.

Andrea Donà: What happens when two networks merge? Masts have to be decommissioned and removed to create savings on energy, rental and rate, which then get reinvested into the network. The masts that we have decided to keep in the final configuration of the network will need to be built on, so the infrastructure will need to be enhanced. There will be a substantial infrastructure investment.

We made a bit of an estimate. We believe it can create up to 12,000 jobs because we need to move the antennae and the electronics from the sites that we will decommission to create the synergies and the savings and build on the ones that we decide to keep in the final configuration of the network as the MergeCo. That needs a lot of labour. We are going from 18,000 today to 26,000, which will need to be built out. It will have to be built out in a relatively brief period to unlock the growth that the business plan is built on. It will generate jobs in the ecosystem of the telecoms industry to realise this and bring it to life.

If I can give you the scale of previous consolidations that I have been part of in the past, in 2007-08 Three and T-Mobile merged to create the MBNL network. That network was 18,000 plus 7,000 down to 12,000 sites. We are talking about twice as big a network consolidation of what was consolidated only 13 years ago. That gives you a flavour of the scale of what we are doing, compared with what was previously done here in the UK.

Ian Lavery: That is interesting, because the trend with mergers is normally reductions in the workforce. From what has been said, that will definitely not be the case. That is what you have said: that in fact there will be lots of jobs created and there will be no occurrences of potential compulsory redundancies, for example. At the moment, the workforce are worried about that. The workforce want a successful company and want to work in a successful company, but are concerned about compulsory redundancies. From what you have said in your responses, that can be put aside. In fact, more jobs will be created, which is interesting.

What are the key management challenges in delivering an efficient merged company?

Andrea Donà: There is the complexity of bringing two networks together. I compare it to keeping a patient alive with open heart surgery, because you have to move all these consumers from one network seamlessly to another network. The IT systems need to migrate. Two companies are coming together with two cultures that have to merge, align to the culture of the new joint entity and rally the employees to believe in the vision that this new company will deliver for the UK, the customer, the country and the consumer. It is bringing two corporate cultures into one that are aligned to that great ambition and great vision that we have in mind.

David Hennessy: I was the chief technology officer—I still am—for Three Ireland as well, and I oversaw the merger of O2 Ireland and Three Ireland in 2015. The challenges are, first, that you have to get cultural alignment between the two companies. You have to bring the companies together and get a common vision of what you are trying to do.

You have to put the customer at the centre of what you are trying to do. When you put two businesses together, the value is in the customer base. You have to take care of your customers and make sure that you have a seamless integration programme. It is a complex integration putting these things together.

Invest, invest, invest. The value is in the customers. You keep the customers through the investment. You have to do that because the last thing you want to do is merge two companies and lose half your customer base. You have to put the customer at the heart of what you try to do. That is the biggest management challenge by far, because you cannot become driven by, "I have to get this saving or we cannot do this." You have to be driven by keeping your customers happy.

Andrea Donà: We saw evidence in a previous merger that happened in the UK, when Three came together with T-Mobile when the MBNL network was merged. As soon as the network consolidation happened, the investment needed to be made immediately to add the additional capacity. One challenge is to ensure that the capacity that is required to service a new customer base is kept in the network and the reinvestment happens in the network, because it is a false economy. If you do not reinvest in the network, as soon as you finish this transaction, you have to invest in it immediately after. Do not get into that cycle of false economy.

Q40 **Ian Lavery:** Thanks. Finally, what are the key risks of the merger for the consumer and the employees? How do you propose to mitigate them?

David Hennessy: We can be prophets of doom and say, "If this merger does not happen, terrible things will happen in the market and we will struggle." The biggest risk by far is that we wallow in this mediocrity in the quality of our networks and the state of the market.

The stats that I quoted earlier speak for themselves. We are not the leading network or the leading nation for mobile telecoms. We have to close the digital divide. I find it hard to see how that will happen properly. We have to improve 5G services in all these additional towns that currently do not get 5G but will with the merger.

I see the risk that if this merger does not happen, we will continue to be laggards. We deserve much better. The future is about growth, and we have to support that through better infrastructure.

Andrea Donà: The risk is that we will not unlock the benefit that is inherent in this 5G technology. The Government's own study shows a £150 billion benefit, £1.9 billion to smart cities economic growth and £1.3 billion to the public services potential economic growth because of 5G. The risk is that if we do not draw it out we will not unlock that benefit.

Q41 **Ian Lavery:** What are the key risks for the consumers and employees, not the company? What are the key risks for the loyal workforces of both companies in the merger?

Nicki Lyons: The biggest risk to employees and consumers is the failure of each company. We are falling behind. We are struggling to compete with the two much bigger-scale companies at the other end of the competitive scale. If we end up failing, consumers will have less competition and fewer options to choose from and our employees will no longer be employed by us. A significant risk if this deal does not go ahead is that the network sector looks dramatically different in the UK in the future. It is hard to say when. It is hard to predict when, but that is a definite risk.

Q42 **Chair:** May I put one final question to the representatives of Vodafone? I can remember a time before mobile phones. As this market developed, Vodafone was a leader—it was right at the top. Today, Nicki, you have used the expression "the failure of each company". You have used the expression "a struggle to compete" and said that the businesses "are falling behind". It seems to me that that is largely because you have failed to attract enough customers to your network, because this is all about the number of customers you have. Is that a terribly sad state for a great company to have got into?

Andrea Donà: To attract the customers—to have our customers want to come to our network—we need to have a reliable service. We need to have coverage in every part: where they live their lives, where they work, deep indoor coverage in buildings like this. We have lacked the scale and we have had to hold back our investment—

Chair: That is sad, given where Vodafone was at the outset of the development of this market.

Andrea Donà: That is the reality of where we are today in our investment and capability.

Chair: Thank you to all our witnesses. We will suspend the sitting for a moment while we change panels. Thank you all very much for coming and giving evidence this morning.