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 43-66

Witnesses

II: Professor Tommaso Valletti, Professor of Economics, Imperial College London, and former Chief Competition Economist at the European Commission; Karen Egan, Head of Mobile, Enders Analysis; Dr Jorge Padilla, Senior Managing Director, Head of Compass Lexecon Europe, Member of the Global Executive Committee, Compass Lexecon; and George Stevenson, Bargaining and Investigative Researcher, Unite the Union.

Examination of witnesses

Witnesses: Professor Tommaso Valletti, Karen Egan, Dr Jorge Padilla and George Stevenson.

Q43 **Chair:** Welcome to the second session of the Business and Trade Committee looking at the proposed merger between Vodafone and Three. We have a panel of competition, consumer and telecoms experts in front of us. We have Professor Tommaso Valletti, Karen Egan, a senior telecoms analyst, Dr Jorge Padilla and George Stevenson.

What did each of you make of the previous evidence session—you were all with us for it—and the notion that the UK market of 60 million people, with more users than 60 million, is not big enough to support four mobile phone networks? Dr Padilla, please.

Dr Padilla: Thank you very much and good morning. Let us look at the US. It has seven or eight times the population of the UK. Its income per capita is greater than the UK, it has an active business sector, it has faster growth, yet it has three networks. The costs of investment in 5G are significant and there is considerable uncertainty. When you combine those two factors, you realise that the number of networks that can be sustained in an economy is limited.

Chair: In principle, there is a strong case?

Dr Padilla: Yes.

Karen Egan: The number of networks is always a balance of consumer choice and duplication of costs. When I look at what has happened in the market over the past few years, the need for ensuring consumer choice among the mobile network operators has diminished, primarily because of the success of the MVNOs, their ability to move, and consumer protection initiatives from Ofcom, while the costs have greatly increased with 5G, with increased security and with the removal of Huawei.

At the same time, industry returns have gone down. Since the last proposed merger, revenues in the sector have gone down by 20% in nominal terms and more than 30% in real terms. At the same time, traffic volumes have gone up tenfold. Running a network in the UK has become a whole lot more expensive, and the revenues available to cover those costs have gone down.

George Stevenson: Here we are looking at a couple of companies looking for a shortcut to increase their profit levels. We have seen them do this in other sectors. In Australia, as we mentioned, they jacked up prices immediately within a year of the merger taking place, but their profit margins doubled since the merger and their dividend payments went up by 2,700%.

In this situation, the UK is perfectly capable of supporting four or many other mobile network operators, but if this merger takes place we will see price rises. We will see profits go up. Our research shows that this will increase pricing power for these companies, and that is their primary concern.

Professor Valletti: Good morning and thank you very much for having me. First, I should disclose that I have no conflict of interest. I am not advising any party in this matter. I do not know about this panel, but I am not.

I have studied mobile telephony for 25 years. In a sense, the question we are debating today is very old. I have heard it over a quarter of a century many times, from analogue to digital and then from 2G to 3G and from 3G to 4G. Every time, we heard, "We need more consolidation to bring investment." I have studied it, I have published about it and I have found no evidence that tells us that by consolidating there is more investment. Instead, I have found that every time there is a merger, prices go up.

I was surprised also to hear that the US is a good example to think about. The US has the most expensive prices in cell phones and telephony in general in the world. Why should that be a good comparison for the UK? France, of a similar size, has four operators. Italy, of a similar size, has four operators. It is sustainable. If you want to find some anecdotes, Cyprus has four operators, Slovakia has four operators and Czechia has four operators.

If you go to smaller countries, by this argument, you should expect to see high prices. You do not, because the argument, which has been over-emphasised on the previous panel, of economies of scale has a limit. At some stage, if you want more investment, you have to add cells, masts, capacity. On the idea that economies of scale are so overwhelming in mobile telephony: yes, up to a limit, but then the UK is big enough to exhaust those economies of scale.

Q44 **Chair:** Dr Padilla, would you like to expand on your case that the American example is good for us to consider?

Dr Padilla: In America, many things are more expensive than in Europe. One reason is that the willingness to pay is much greater, and that explains the price difference. No doubt the level of investment and the level of penetration of 5G in countries such as the US and South Korea is greater than in any European country.

Australia has been mentioned today many times. If you look at the ACCC market report 2021-22, you will read on page 3 that the level of competition for 5G consumers is increasing, not decreasing. If you look at that market report and look at the evidence about prices, you will see that they are decreasing in real terms and, when adjusted for quality, have increased significantly.

The same report says, "MNOs continued to extend 5G network breadth and depth". Any single country in Europe would envy the penetration of

5G that exists currently in Australia. Of course, at some point, when you have deployed the network of stand-alone 5G, you stop investing, but they continued investing. Page 5 of the report says, "Deployment is now moving into regional and remote areas". If anything, the investment situation in Australia is positive. There is no evidence that the transaction that has been referred to a number of times has increased prices.

Chair: That is interesting. We have a different view among our panel.

Professor Valletti: Let me clarify one thing. Prices in mobile telephony have been declining over the past 30 years. They go down because of technological progress. The costs of semiconductors are declining and the costs of microchips are going down. Observing prices going down is no evidence of anything. We have observed that they decline but slowly in markets with three operators. They decline much faster in markets with four operators.

To say that there is no evidence that after the merger in the US prices did not increase is not the right comparison. You have to ask how much it would have gone down if the mergers had not been allowed. That is the right comparison.

Q45 **Anthony Mangnall:** I am interested in that point, because the price of mobile phone handsets over the last 20 years has gone up, not down. That is partly because of the advent of new technology; Apple is a perfect example, but that is perhaps a separate point.

I am also interested in the point Karen made in her opening remarks about revenue being down 30% in real terms. Could you give a better reason for that? Could you expand on why this is the case in the UK?

Karen Egan: The competition in the market is quite intense. MVNOs, over that time in particular, have been doing especially well. The increase in capacity available with 5G has made a lot of the operators particularly keen to attract MVNOs. It is much easier now for MVNOs to move between operators than it was in the past. They are able to compete quite aggressively, particularly at the lower end of the market.

That has been to the detriment of Three, which has been trying to compete at that end of the market in particular but has to invest in a network that is in many ways not as strong as the networks on which the MVNOs are able to negotiate increasingly favourable deals. That is one element of it.

There have also been a lot of initiatives by Ofcom to make switching easier between operators. It is tackling out-of-contract price rises and the like. That has had a negative effect.

Essentially, Vodafone and Three have been pushing quite hard in the market to improve their scale because that is a sensible thing to try to do in a scale industry, but the bigger players, O2 and Vodafone, are incredibly reluctant to see that scale. You have a bit of an impasse.

Although Vodafone and Three have been doing the right things, they have struggled to make inroads, at the same time as grappling with the intense competition presented by the MVNOs. Over the past 18 months, according to our numbers, the entire market of MVNOs has been taking more net subscribers than the mobile network operators have. We should not dismiss them as significant factors in the market right now.

Q46 **Anthony Mangnall:** Sticking with you, what effect would the proposed merger have on the telecoms competition within the UK? I am not often to be found quoting Unite policies or views, but I am struck by this point. Is this an easy way for Three to increase its market share, to get new customers and to jump over the hurdle that it has been unable to jump over for the last few years because it has not been able to scale up?

I am sorry that we keep coming back to Australia, but it is a useful example because we will all see the report that goes to the CMA at some point and we will have to listen to its findings. It was not just the fact that the merger resulted in a price increase for Three and Vodafone; all the other mobile operators increased their prices as well.

Is there a wider point here? Could this merger be bad for the entire sector when mobile companies put their bills up for the consumers?

Karen Egan: There is a lot in that question, but I will start with the competition side of things. It is quite clear that a merged Vodafone and Three would be a much stronger competitor at the top end of the market for the high-end consumers who want a reliable network and are prepared to pay for it. For IoT partners, for tech partnerships, in all those areas, you would have a much more credible player to compete against the other two. That is an important part of the market.

A lot of the concerns stem from what happens at the lower end of the market. It is fundamental to understand that, quite unlike most mergers, this merger would result in an increase in capacity in the market and an increase in supply because the spectrum available to the mobile operators stays the same but is less fragmented, so it provides greater capacity in the marketplace. Added to that is the fact that the 5G roll-out for the merged entity would be much greater than if they had been stand-alone. Contrary to almost every merger in the world, you have an increase in supply.

In a network industry, the supply is absolutely fundamental, because the imperative is that you have a fixed base with a lot of capacity and you fill that as well as you can at the best possible price you can get. You see all the operators doing that. They operate at the top end of the market. They have sub-brands for the lower end of the market. They fight over giving MVNOs the best deals that they can to attract them. It is "Fill your network", and there will be a whole lot more network to fill.

In fact, the MVNOs in particular have marginalised the Three network. That network for them has not been under consideration. Apart from the greater capacity in the market, the capacity addressable by the MVNOs is much increased as well, because they will be looking at all three players and getting them to compete against each other for their business. You can expect competition and pricing to remain quite intense at both the top end of the market and the lower end of the market.

On the issue of pricing, it is important to note that figuring out what happens to prices in all these markets is not an exact science. How do you account for the myriad offers out there and the various pricing packages? How do you weight them? How do you take account of different changes in usage? I do not like to look at individual case studies, because one way of looking at it will tell you that prices went up and another way of looking at it will tell you that prices went down. As we saw, we had different voices on the Australian example.

I prefer studies of studies from players in the market who are objective. In a 2021 study on what happens to prices when you have mergers in this situation, Ofcom concluded that it is difficult to be conclusive about it and that the evidence does not particularly point one way or the other, because the increasing capacity makes it different from other mergers in other sectors. These mergers are not predicated on increasing prices. The efficiencies and the avoiding of duplication transform the economic fortunes of the operators and allow them to invest much more effectively.

Q47 **Anthony Mangnall:** I accept your point about MVNOs, but I am concerned that we are in a situation where we have three enormous companies as MNOs controlling the whole network without the ability to have disrupters at the smaller end of the scale to rise up. We will then, essentially, have three companies controlling the whole system in future. That is my concern about this.

I will wrap up with my second question. George also wanted to come in, so I will stick with Karen and then go to George. What steps do regulators need to take or should take to protect consumers in this merger?

Karen Egan: You will continue to have intense competition between those operators because they all operate at every level of the market and they will all have more capacity that they need to fill. They will all have to compete more effectively at every one of those levels. They will have to compete more intensively for the MVNO business. These networks are incredibly expensive to—

Q48 **Anthony Mangnall:** Sorry to jump in, but the evidence that we have seen in our briefing documents has shown not only that you have price rises between the three MNOs, but that they are also being fined for similar issues. Again, I am using Australia as the example. Forgive me for sticking on this one example, but all three top MNOs in Australia are collectively fined for these things. That is not competition; that is collusion.

Karen Egan: Not only is the Australian example that you cite one example, but it is one perspective on one example. Other perspectives are available, including from the Australian regulator, about what has happened in that market. I have not seen evidence that there has been an increase in the number of complaints because of the network quality in Australia.

Q49 **Anthony Mangnall:** It is not a perspective that the Australian Competition and Consumer Commission fined the top three companies. It is a fact that it happened.

Karen Egan: But did it fine them before the merger happened? Regulators fine operators all the time. Ofcom says that no evidence backs up the view that these mergers lead to an increase in prices. Pinpointing one particular example and one particular perspective does not override that view that Ofcom has come to from an extensive study. Indeed, if you take a snapshot across the OECD of the concentration of the market versus the pricing levels, as we have done in our research, no correlation suggests that more concentrated markets have higher prices. The evidence is just not there in a snapshot.

Q50 **Anthony Mangnall:** I do not want to step on Andy's toes, because I know he will come on to pricing in further detail in a minute, but what do you expect from the regulators in protecting consumer interests?

Karen Egan: The CMA will need to satisfy itself that the market will remain competitive and that the regulator will not need to step in to protect them beyond what it does already. Ofcom is proactive in this space. It is focused on transparency for consumers and consumers' ability to switch and be well informed. They keep a close eye on all that. The CMA will need to satisfy itself that that will continue to be sufficient, which we believe it will.

George Stevenson: There are different views on this point. You may not be happy quoting Unite, so maybe you could quote Moody's credit agency instead. Earlier this year, as the Committee will know, the highest court in the European Union ruled that blocking the Three-O2 merger from 2016, which was very similar to this one, was the correct decision because of its impact on prices. Moody's response to that was to say, "This means there is likely to be continued intense competition among operators, particularly in markets with four mobile operators, reducing pricing power".

That is what this comes back to. Our research has shown this again and again. It is not just one case study; it looked across all of Europe. It looked across Tommaso Valletti's research as well, which has looked at multiple mergers. Prices will be higher—in our research, 20% higher—in European countries and markets with three operators than they are in those with four. As Professor Valletti said earlier, it is interesting that even if prices come down because of efficiency savings and because of new technology becoming cheaper, in markets with four mobile network operators, guess what, those prices come down more than they do with three mobile network operators.

Pricing power is absolutely key to this competition issue. There is a possibility of creating a collusion network, a cartel or whatever you want to call it. This will increase pricing power for these companies.

Chair: Professor Valletti, do you want to come in on that before I go to Andy McDonald?

Professor Valletti: The question is what regulators can do in case prices go up after the merger. The honest answer is very little, in the sense that Ofcom does not have the power to regulate prices. Of course, if there is an explicit cartel, fines can be imposed, but if the market becomes more concentrated and cosier and competition is less intense, nothing can be done ex post.

There is a policy instrument ex ante, which is merger control, so that is the question now. Regulators can do something now before the merger takes place but afterwards, to be honest, there will be something at the margin. Ofcom is not a price regulator.

Karen Egan: However, Ofcom could go through a process if it decided that the market was not functioning as a fully competitive market. It could investigate and decree that one or more players has significant market power. That would allow Ofcom to intervene in the market much more aggressively. Of course, it is not a desirable situation but it is a backstop if ever it decided that it was not a perfectly functioning competitive market.

Chair: I will go to Andy McDonald now on this item. I know Dr Padilla wanted to come in.

Q51 **Andy McDonald:** Can we cite examples of Ofcom intervening in that way in this market—determining that there was a concentration and taking action? Can you give us some succour that that has happened?

Karen Egan: It has looked at the market in the past and has decided that no player has significant market power. It has chosen to treat it as a fully competitive market.

In the fixed business, Openreach is decreed to have significant market power, and therefore Ofcom tightly regulates its pricing. It is not an ideal situation, because regulators much prefer competitive markets to highly regulated ones, but it could go down that route on the mobile side if it ever ultimately decided that it was not a competitive market. But it is a long way from not being a competitive market right now.

Q52 **Andy McDonald:** These powers are rarely used. Whatever your assessment of the origins of why that is the case, they are rarely used.

On this business of prices and price rises, we have heard a lot of evidence from you this morning as to whether that has happened. I am confused because surely it is relatively straightforward to work out, if you have a market with four MNOs and it changes to three, whether prices have gone up or down or stayed the same.

Why is it such a complex issue? What representations have any of you made—I would like to hear what George has to say about this—to put that evidence to the CMA? Why is it so complicated? Surely what consumers pay is straightforward.

Dr Padilla: It is not that easy, because you have a number of tariffs and then you have different consumption patterns. Some people focus on some tariffs and some people focus on other tariffs. Then there is the issue of adjusting for quality. People think that there is a way of adjusting for quality, for example by looking at prices per gigabyte. Others will adjust for quality in different ways. That explains the differences.

Q53 **Andy McDonald:** I am sure it is infinitely variable and you can factor in things in all sorts of ways, but when people go to work they have a finite amount of disposable income. Having connectivity to these networks is now essential to life. This is not a nice-to-have. The only way you can engage economically is if you have one of these things and a good connection.

I am trying to get to the nub of this. Does it cost working people more or less to be connected to these services in circumstances where you change from four to three?

Dr Padilla: If you look at when you pay for what you get, the evidence is exactly the opposite of what you have been told so far. The evidence is that prices per gigabyte have gone down in Austria after the merger, in Ireland after the merger, in Germany after the merger. By the way—

Andy McDonald: The cost of the acquisition of the things is the issue for people.

Dr Padilla: When you pay for what you get, it is a better deal after the merger in all those places. By the way, in Australia, it was not a merger between four MNOs to produce three MNOs. It was a merger between an MNO and a MVNO, which had said that it would not develop a network and yet the ACCC felt that it would despite its public statements. Again, I dispute the claim that prices have gone up. That is not true. Again, prices per gigabyte, when you pay for what you get, went down in Australia as well immediately after and then until today.

Q54 **Andy McDonald:** Thank you. George and Tommaso, what is your perspective on this, in terms of the evidence that you have amassed and what you have submitted to the CMA?

Professor Valletti: This is probably my turf. I collected quarterly data from 2000 until 2015 because there have been a lot of changes in mobile markets across the world. I assembled datasets with more than 6,000 observations, trying to control precisely for countries having different efficiencies, different qualities and different consumers subscribing to different packages. I have done all this. The results—I do not want to bombard you—have been published in an academic journal subject to anonymous refereeing.

Some of the evidence that we are told about is nothing to do with publishing to good academic standards. These are reports from the industry—as you would expect, advocacy. These are lobbyists and that is what they do. You have to be careful when you interpret that evidence. My hyper-study has been refereed and published in an academic journal.

I did a lot of stuff in that study, but I address specifically one question: what happens when there is a four-to-three merger, on average, because there are different countries? The answer is unambiguous: prices go up by 16%. If somebody can challenge me with better data and better evidence, I am open to that, but the scientific evidence is unidirectional.

I can quote a lot of other studies published in academic journals, and I want to draw a distinction there. You should also digest the information submitted and understand whether it has been vetted. Normal published academic studies point in one direction only, so I was a bit surprised by statements by Dr Padilla, to be honest, because evidence is evidence.

Dr Padilla: We have also reviewed all that evidence, published and non-published, looking non-selectively at the different studies out there. This evidence will be submitted to the CMA. It shows that even when there is a price effect from the merger, it is short-lived and not when you adjust for quality.

The analysis of Professor Valletti is interesting. It is dated with regard to the nature of the networks. He misses the point, because we are not talking about any merger. We are talking about a merger in an industry with two industry leaders, two laggards and a number of MVNOs. We should focus on that. In fact, we should not focus on Australia or the US. We should focus on the merger here, a merger that will create a third network.

You asked before: what about MVNOs? MVNOs at the moment have two networks, by and large. They will have three networks. There will be less control. They will have more opportunities to trade one network against the other when dealing with them and obtaining better terms with which to compete for consumers. We should focus on the particular characteristics of this industry and these markets. We have two companies that are subscale and the merger will increase their incentive to invest. They will reduce the incremental cost of those investments. That will drive the outcome of this merger in the UK in the coming years.

George Stevenson: A lot of hope and expectation is placed on this, rather than the reality of what has happened previously. Our research has shown that when we looked at not just one network, not just one market, not just one set of operators, but across Europe, and when we compared the price levels in European countries with four versus three mobile network operators, those with three were 20% higher than those with four. Yes, sometimes prices come down but, again, when you compare how much they come down by with three versus four, four mobile network operators mean more competition and the prices come down further.

This is, again, about pricing power. We have not looked at just one particular case study. We have looked across the world at how these mergers have happened and the impact that they have had.

Also, in the panel this morning we have heard a lot from Jorge about how they will submit to the CMA. You will notice that Professor Valletti's research and the dossiers that we have published are publicly available. They are on our website. They are open to scrutiny from MPs and other bodies. We do not see any willingness, it seems, from these companies to face democratic scrutiny. They want everything done behind closed doors, whether it is the Investment Security Unit and the national security concerns or whether it is now the things they submit to the CMA. We want this out in the open. We want democratic scrutiny from MPs, because this will matter to every single constituent in this country. We will keep putting that forward, including submitting to the CMA.

Karen Egan: Hopefully, to round up this discussion, I reiterate that it is important to look at comprehensive, up-to-date studies done by those whom we can rely on to be as objective as possible. That is the 2021 study by Ofcom, which concluded that the evidence is not there that four-to-three mergers lead to increasing prices, with all due respect to Unite and Moody's and the 2016 study.

Professor Valletti: With all due respect, that is not what Ofcom says. If you read the report, the evidence on the prices is—anyway, you can read by yourself what Ofcom says.

Can I make a comment on MVNOs? They have been mentioned quite a lot. It is great what companies like Tesco do, but let us not overemphasise the role that MVNOs play in the market. As we heard earlier, they have something like 15% of the subscriber market share. The market share of revenue is much lower because they typically attract consumers at the bottom, people on cheaper contracts. The role that MVNOs have is limited. Let us not overemphasise it. The market is made by the MNOs.

Also, from the perspective of the MVNOs, I thought that there was a contradiction in the previous panel. We were told that it is easy to switch from one host network to another; we were given evidence from the Vodafone representative. How on earth can an MVNO be better off if before the merger it could go to four host networks and now it can go to only three? Now everything has been turned around and the merger is seen as an entry into the market. The merger is an exit. An existing operator will disappear. MVNOs will find fewer opportunities to be hosted by physical infrastructure.

Dr Padilla: Three has not won a single MVNO contract since 2018.

Professor Valletti: But it is available as a possibility.

Dr Padilla: Three is out of that market and Vodafone does not have the capacity.

Chair: We need to have one speaker at a time. It is great that we have a different view here. Of course, Jorge, we have had an hour with the companies involved immediately beforehand, providing the scrutiny that this Committee is here to do.

Q55 **Douglas Chapman:** I have a quick question, following on from previous questioners' contributions. We were given a couple of guarantees from the previous panel regarding pricing and the roll-out of the improved infrastructure to different parts of the country. We have heard that the pricing sanctions that Ofcom may apply might be fairly limited. What sanctions could be applied if the roll-out programme is not adhered to?

Part of the thing for me with 5G is that we begin to spread the improvements to productivity across all parts of the country, as opposed to focusing on London and the south-east. How do we put the emphasis on making sure that that roll-out happens and has an effect on the economy in the longer term?

Professor Valletti: Competition is a good way to ensure that investment happens because firms compete by offering better products. Who wins in the market? The one who can offer the best deal for price and quality. Competition is a good guarantee that investment will happen. But will a regulator have sanctioning powers in case their plans do not go as announced? The answer is, again, no. Look at what happened in the last few years—Ukraine happened, covid happened. Something always goes in a different direction because the future is uncertain. No commitment can be put in a contract. There are promises and probably well-intentioned promises. The companies do not intend to do this.

But can we be sure that these investments will happen if the merger goes ahead? The honest answer has to be no. On the contrary, if you reason on the impact of the merger on investment, ask about the evidence and ask whether competition will play a role in the context, but there is no guarantee.

Karen Egan: When we look at the evidence on what has happened to investment levels across mergers of this type, pretty much all the studies point to the view that investment overall in the country remains at the same level. There is no real change. However, of course, that investment is considerably better deployed. Instead of being deployed in duplicating networks in London, it is deployed in expanding the quality and the reach of the network elsewhere. We have seen that again and again in mergers like this.

The reason for that is that these mergers are not predicated on increasing prices or reducing investment. They are predicated on extracting scale synergies and putting the companies on a much more sustainable, long-term trajectory. That absolutely requires them to have a network that can compete with the others. I can tell you that EE's network is not competing with Three's network right now in the UK. It does not base its investment plans on what Three does. You do not need four players—

Q56 **Chair:** Why should it? One is much bigger than the other.

Karen Egan: EE has the best network in the UK, with much more—

Chair: Why should it be bothered about what Three does?

Karen Egan: The argument made by others is that having four networks is the best way to encourage investment for all. I dispute that. Three networks with a merged Vodafone and Three will provide much greater impetus to the others to invest. We have seen that that is the case across pretty much every study that has been done.

Dr Padilla: In other words, they will worry about the network of the merged entity after the merger has happened because then they will have a network that competes head to head.

There are two reasons to believe that those promises are sincere. First, what can you expect in investment, absent the merger with a company that has a return on capital employed of 1% when the cost of capital is 8%? Will it continue investing? The answer is no. The same applies to Vodafone. The difference is not as stark, but the company still has a return on capital employed way below 1%. You do not put in more money. That doubles up on losses.

At the same time, the transaction increases the incentives to invest, for two reasons. First, with the economies of scale, as you heard from the previous panel, you can defray fixed costs on a larger number of units. Secondly, it also reduces the incremental costs of the investment. As Karen has mentioned, capacity is a function of size, the spectrum and investment. The return from investment is much greater when those investments are applied to a combined spectrum and a combined number of sites. That is why those promises are believable and credible.

George Stevenson: We need to pick up on this consolidation issue, because Vodafone itself says that the merger is expected to result in £700 million of annual savings. That is by year 5, not year 1, after completion. This £700 million appears to be spread in quite a lot of directions. We have heard that they promise billions more in investment—over £1 billion a year in the first five years. That is already more than is coming back in savings. Apparently, after the merger, investment will stay the same. The savings that they will supposedly make are not enough to cover the new investment that they promise. It will also apparently deliver from this magic pot of money more jobs in the sector and price freezes.

It is fascinating to me. Where exactly will this money for investment come from? We keep hearing about cost savings and about consolidation, but there is a limit to how much that can achieve. Either it will come out of increased price rises for consumers and job cuts, which is what we would expect from looking at other mergers around the world, or these investment promises will be as empty as they have been in previous mergers—like in Australia, where investment levels went down by 45% across the sector. They cannot have it all ways.

Q57 **Antony Higginbotham:** I want to drill down a bit on investment and competition. It seems like there is a split of opinion. Dr Padilla, you contend that there are not four players in this market, but two significant players and two laggards. Is that broadly right?

Dr Padilla: First, there are many more players, because we have the MVNOs, but if we focus on the MNO dimension, you have two players that have invested and obtained a return on capital employed way above mark. Secondly, they have a return on capital employed way below mark. In that situation, the industry has two leaders and two laggards. That means that the laggards will not be able to compete and put a competitive constraint on the leaders unless they do something. They need to gain the scale. That can be done only through a merger.

Q58 **Antony Higginbotham:** Can that be done only through a merger? What would have to happen for the two laggards to catch up, essentially? Is that realistic, with the scale of investment needed for a 5G network?

Dr Padilla: They need to invest. They need to invest in the network. They need to be able to deliver the same level of quality as their leading competitors.

Q59 **Antony Higginbotham:** Could they do that as two stand-alone MNOs?

Dr Padilla: They do not have the economies of scale. Also, the effectiveness of the investment is reduced because they have a split spectrum and split sites. They have less effective investment and it is more costly per unit, because they cannot defray fixed costs on a greater number of units.

Q60 **Antony Higginbotham:** If we take that forward a decade, assuming no merger, what will the MNO landscape look like in the UK?

Dr Padilla: Forecasting the future is a difficult exercise and we economists do not have a great track record, but something will have to happen. Otherwise, these two companies will dwindle down over time. The exit mechanism is hard for me to predict, but it is clear that the degree of competition and the strength of competition between MNOs will reduce over time unless investment is made by the laggards.

Karen Egan: When you look at Three's cash-flow position over the last three years, it has been losing cash consistently. The Hutchison group will not want to sustain that. I expect it to cut right back on spending, to try to hold on the subscribers it can, to stop pushing the market and to perhaps become somewhat marginalised. Certainly its 5G coverage would be quite limited to urban areas and would not extend beyond that.

Vodafone, according to our numbers, is making a 2% return on capital employed—way below what it could get from the bank. The Vodafone group is taking a much more pragmatic approach to underperforming assets. For example, it is looking at selling its Spanish unit to private equity, according to press reports, at least at the moment. Unless it can transform the fortunes of Vodafone UK, it would start to strategically question its ownership of it, ultimately.

Professor Valletti: On the question of the financial viability of Three and Vodafone, we heard a lot that they are struggling. Maybe they are. I want to make two points. First, it is up to financial markets to make decisions about whether they want to fund their own investments. Tweaking competition policy to give advantage to particular firms is not the right policy instrument.

More importantly, imagine that they are struggling and they want to make this argument in front of the CMA. They can use a route called a failing firm defence that they can use in front of the enforcer and make a case. The hurdles are high to prove such a case, but it exists. It is embedded in the merger analysis that the competition authorities will do. Again, it seems their attention is distorted in other directions.

I agree with one thing on the available evidence: mergers do not change the investment at a country level. I heard also that they can locate investment better. I have never seen that evidence. I would be happy to review it when it is submitted, if I have an opportunity.

So far, where we stand on the empirical evidence on mergers, especially four-to-three, is that the cost to consumers is certain because prices are increasing. This cost is sure for the UK economy, especially for every UK citizen since every UK consumer has a mobile phone and in some cases two. It is especially so for UK small businesses, because they do not have the countervailing power to negotiate good deals with the network operator.

A certain cost arises from the merger in exchange for a promise that perhaps investment will go up. An uncertain promise cannot be enforced by law because these investment plans are difficult. That is where we currently stand.

Karen Egan: But would you accept that after mergers like this in the past, investment levels overall in the country have remained the same, and that if you spend less money on—

Professor Valletti: Yes, I found that in my research. I said that that is the only point—

Chair: One speaker at a time, please.

Professor Valletti: You are right. My apologies.

Karen Egan: If you spend less money on duplicating networks, that will inherently imply that you are spending more money on improving the quality and reach of your network.

Professor Valletti: No, you make an illogical step that does not follow. For instance, in our data, as limited as we are with available evidence, we could figure out the capital expenditure. I could follow the cap ex of operators before and after the merger. At the country level, this would not change, but I do not know where the cap ex went. Nobody has this information.

Q61 **Antony Higginbotham:** If the merger goes ahead, we have been told that £11 billion will be spent on upgrading the network to an advanced 5G stand-alone network. Does that sound broadly right, as a ballpark figure, to get to a point where we end up with three prominent MNOs that can compete with one another?

Dr Padilla: Based on my understanding, the network that the merged entity will have will be able to compete head to head with BT/EE's network and also with VMO2's. Therefore, I expect that it will be a credible player that will enhance competition in the consumer segment and, in particular, in the business segment, where having a high-quality network is fundamental and where at the moment, for example, Three is not playing at all.

Q62 **Antony Higginbotham:** It could become a credible player at that point, but you are saying that it is not a credible player in that at the minute?

Dr Padilla: At the minute, it is not a credible player. Three has such a network that it is not able to compete for MVNOs and has a market share of 2% or less for businesses and concentrated and so forth. It is not a player. It has been unable to grow its market share over the last years in the consumer segment without the scale.

Q63 **Antony Higginbotham:** What about Vodafone?

Dr Padilla: Vodafone is stronger in business but has not grown much. It has been losing share and importance in the wholesale market and is not growing either, in the consumer segment. It has not been able to invest sufficiently to keep up with BT/EE and VMO2. As a result, it has to compete fundamentally on price with MVNOs and is unable to obtain the returns to fund the required investment.

George Stevenson: Fundamentally, these companies are looking for a shortcut. Three is a company owned by CK Hutchison. CK Hutchison's shareholders are getting antsy about the fact that they have not received the dividend payments that they expect in recent years. This is an excellent opportunity for Three to help to provide some of those dividends by cutting back on its costs, by increasing prices in the future and by increasing its returns. This is a shortcut for it.

Vodafone is in this mess—and this was hinted at by the previous panel—because of mismanagement and neglect. You do not have to take this from us. You can take this from Ben Marlow, the *Telegraph*'s chief City commentator, who wrote earlier this year, "Dogged by numerous IT failures, endless executive changes and uncompetitive pricing, the Vodafone brand has been allowed to wither and it has slipped from leader to challenger". The company is on its third CEO in five years. They have all been handsomely rewarded for their failures, including the former CEO Nick Read receiving almost £3.9 million in his last nine months alone. This was after overseeing a 43% drop in the company's share price. The issue of viability is getting caught up in the fact that this company is incredibly poorly run.

Another company, Three, does not wish to wait to get its returns on investment. It wants to try to cash out now. We see these companies trying to have this fixed for them by regulatory change, by the shortcut of a merger, instead of playing out the market conditions.

Q64 **Chair:** Mr Stevenson, if Mr Lavery were still with us he would want to put a question: what is the likely impact on employment and on the workforce in both organisations? If we do not go from four to three by means of a merger, from what Karen Egan has said to us one will exit anyway. Is the sector about to experience some job losses, whatever happens?

George Stevenson: We can only speak to what is supposedly proposed here, which is this merger of Three and Vodafone. Based on our research on comparable mergers in the UK and the US, we expect job cuts in the region of 1,000 to 1,600 for Three and Vodafone staff. We know that Vodafone is not exactly shy to cut jobs. It is in the process at the moment of axeing 11,000 globally, including in the UK.

We also know that Three is no better when it comes to looking after workers. Indeed, the actions of its parent company CK Hutchison at the port of Felixstowe brought it and this merger to the attention of Unite in the first place. Last year, during legal industrial action against CK Hutchison, the company sacked four Unite reps on trumped-up charges. Those reps had worked for that company for a combined total of over a century—over 100 years of work for that company—and they were dismissed on nothing. One of the four was undergoing cancer treatment through the disciplinary process and was sacked while off with a doctor's note. Another was referred to by the name of a different rep during his disciplinary meeting. One of them received a letter from the port congratulating him on 25 years of service—

Chair: With the greatest respect, this is not Three. This is another company.

George Stevenson: This is the company that owns it. CK Hutchison is the owner of Three and, essentially, that means that—

Chair: But it is not the management of Three. That is the point I make.

George Stevenson: It would be a strange situation if we assumed that the management of a parent company would not have some control and insight over what goes on at the companies beneath it. This is clear anti-union activity by one of the parent companies involved in this merger. This type of management, when coupled with the job cuts that we have seen from Vodafone and in other mergers of this type, is a very worrying sign for workers in these sectors.

Q65 **Andy McDonald:** That point was eloquently made, but I want to come back to the point about avoiding duplication, because that has been the justification for investment. It occurs to me that if those costs are saved, it can go in one of two ways. It can go into genuine investment in other areas or, alternatively, it can do what Mr Stevenson is talking about, which is addressing the concerns of shareholders. Are we not right to be anxious about that?

Karen Egan: Absolutely, because it is important for the country that we have good-quality networks and that we have a number of them to choose from. In some ways, it is a concern. In other ways, it is important to understand that the incentives for this company are to have a good-quality network. They do not do this to get approval for the merger and say, "We will give you that if you give us the approval." They say, "This is how we get ourselves on a sustainable long-term footing." Three knows better than anybody else in this market that if you have an inferior network, you will struggle to make inroads, not just with consumers but with tech giants, with partnerships and with businesses. They do not promise this in the hope that they can forget those promises, ultimately, once the merger is approved.

Dr Padilla: From that perspective, whether there are two networks or three networks going forward, the benefits for the UK economy, and in particular for productivity, growth and workers, are clear. You want to have an advanced 5G network in the country.

Q66 **Andy McDonald:** Those benefits to workers would be most welcome. I understand that we talk continually about the wider impact on the economy. The concern for this Committee, while it might not be a matter for the CMA, is the way in which the workers of these companies are treated now. Have you done any work or given any thought to the ultimate outcome?

Professor Valletti: Yes. Perhaps an uncontroversial point is the following. Why are we concerned with monopolies? Monopolies try to reduce quantities to squeeze high prices in the market. The other side of the same coin is what we call monopsony. This company may also want to restrict output to give cheaper wages to the workers. If you do something good for consumers, you will end up doing something good for workers as well. Consumer welfare and the welfare of workers go hand in hand. This is an uncontroversial point. If you promote competition, you also promote the wellbeing of the employees.

From the evidence that I have seen, with every merger prices go up and quantities go down relative to whatever is happening elsewhere in the economy, and they fire people. This is all the evidence that I have seen. This is repeated and repeated.

Is the current merger in the UK different from anything we have ever observed so far? The law of physics applies in the UK as it applies anywhere else in the world. The technology is the same. I am sure my research is outdated. Better things will be put forward to the CMA, but all the evidence that I have investigated so far in a quarter of a century of academic independent life—I reiterate that—is telling me that these mergers are bad for consumers, bad for productivity, bad for workers and good for the shareholders.

Also, ask yourself who these shareholders are. CK Hutchison is in Hong Kong. The biggest shareholder of Vodafone is BlackRock and a telecommunications company from the Middle East, e&, and then there is Vanguard and HSBC. These are the biggest shareholders.

Dr Padilla: No matter what we say here, economists do not disagree with the fact that mergers that do not produce synergies can generate anti-competitive effects and can lead to price increases and reduce quantity and employment. But this is not the sort of merger we are talking about. We are talking about a merger that involves significant investment because of synergies. Economists agree that if there are synergies, the mergers can be pro-competitive.

We believe that this is pro-competitive. If we are right and this strengthens sustainable competition in the long run, as opposed to the opposite, there may be redundancies if duplication and overheads are eliminated, but the net effect on employment must be positive in the industry, let alone in the economy as a whole. If I am wrong, the CMA needs to make sure that I am right.

Chair: I am afraid we need to draw our session to a close. Let me say to each of our witnesses that if there is anything further that you have not had the opportunity to say to us today, please put that evidence in writing.

This was probably the most animated session of this Committee that we have had in many years. It has been interesting to have a conflict of views between our experts, and interesting to hear beforehand from the companies involved in this. The question for us is whether four or three will be better for the long-term future of this important market. In the meantime, thank you very much to our witnesses for their time this afternoon.