



**Anticipated Acquisition by BT Group plc of EE Limited**

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**Vodafone Response to Provisional Findings**

**19 November 2015**

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## 1. EXECUTIVE SUMMARY

1.1 Vodafone welcomes the opportunity to present its views to the Competition and Markets Authority (“**CMA**”) on its provisional findings (“**PFs**”) that the proposed acquisition of Everything Everywhere (“**EE**”) by BT Group plc (“**BT**”) will not result in a substantial lessening of competition (“**SLC**”).

1.2 Vodafone strongly disagrees with the CMA’s PFs and considers that the proposed merger would result in an SLC. As set out in Vodafone’s previous submissions, Vodafone considers that:

- (i) **Mobile backhaul input foreclosure:** Post-merger, BT/EE would have the ability and incentive to engage in foreclosure strategies against the other MNOs in relation to mobile backhaul. As a result, the merger may be expected to result in a SLC in the UK retail and wholesale mobile markets.<sup>1</sup>
- (ii) **Retail mobile:** Post-merger, BT/EE will hoard some or all of BT’s spectrum, compared to BT using its full spectrum capacity to provide a competing retail offering in the counterfactual, and this may be expected to result in a SLC in the UK retail mobile market.<sup>2</sup>

Vodafone is also concerned that post-merger, [redacted]. In this situation, Vodafone would not have the ability to compete effectively with the other MNOs and, as a result, the merger may be expected to result in a SLC in the UK retail and wholesale mobile markets.<sup>3</sup>

- (iii) **Wholesale broadband:** As a result of the merger, BT/EE would have the ability and incentive to foreclose superfast broadband (“**SFBB**”) inputs by increasing the price of VULA (or reducing its retail SFBB price while leaving the wholesale price unchanged) which would foreclose competing SFBB providers. As a result, the merger may be expected to result in an SLC in the retail broadband market.<sup>4</sup>

<sup>1</sup> See in particular Initial Phase 2 Submission, Section 2; Letter dated 12 August 2015, Section 1; Letter responding to parties’ and Ofcom’s submissions dated 3 September 2015 (“**Ofcom Letter**”), Sections 1 to 5; Letter responding to TOH 4 dated 3 September 2015 (“**TOH 4 Letter**”); and Letter dated 11 September 2015.

<sup>2</sup> See in particular Initial Phase 2 Submission, Section 3; Letter dated 12 August 2015, Sections 2 and 3; and Ofcom Letter, Section 6.

<sup>3</sup> See in particular Initial Phase 2 Submission, Section 4; and Letter dated 12 August 2015, Section 4.

<sup>4</sup> See in particular Initial Phase 2 Submission, Section 5.

- 1.3 In relation to wholesale mobile, Vodafone is committed to remaining a key competitor in supplying wholesale mobile services to MVNOs. Provided the backhaul, network sharing and spectrum issues are addressed, Vodafone agrees with the CMA's PFs that the BT/EE merger will not create or enhance BT/EE's ability and incentive to engage in a strategy of total or partial foreclosure against fixed-MVNOs.
- 1.4 The reasons for Vodafone's views have been outlined in detail in Vodafone's previous submissions to the CMA, which remain relevant to the CMA's ongoing assessment and the CMA should reconsider them in relation to the PFs. Nothing in the PFs changes Vodafone's core concerns, as summarised above. This response outlines Vodafone's key additional concerns in relation to the PFs on mobile backhaul input foreclosure, retail mobile and wholesale broadband. It also outlines further views and information in relation to the PFs on wholesale mobile. The CMA should not infer that Vodafone agrees with any statements in the PFs if Vodafone does not specifically address such statement in this response.
- 1.5 In summary, Vodafone's key additional concerns in relation to the PFs are:

**Backhaul: BT Openreach input foreclosure strategies**

- (i) **Incorrect finding of a lack of evidence of past discriminatory behaviour and incorrect reliance on that finding:** The CMA has incorrectly found a lack of evidence of past discriminatory behaviour by BT in relation to backhaul inputs. The CMA has also incorrectly relied on that finding to conclude that it was unlikely that BT Openreach would have the ability to degrade the quality of BT Openreach Ethernet leased lines or discriminate in the development of new BT Openreach products post-merger. There is evidence of past discriminatory behaviour by BT Openreach. Even if the CMA were to find that there has not been evidence of such behaviour, it cannot be used to conclude that the merged entity would not have the ability to engage in such behaviour post-merger given:
- (a) the merged entity would have a greater incentive to engage in such behaviour post-merger; and
  - (b) by their very nature, breaches of non-discrimination or Equivalence of Inputs ("EOI") obligations are difficult both to detect and assess. The fact that there is allegedly not more evidence merely indicates the difficulties of detecting and assessing such conduct and suggests BT has the ability to circumvent the current regulation.
- (ii) **Incorrect reliance on existing and future regulation:** The CMA has incorrectly concluded that BT Openreach's ability to foreclose is constrained by existing non-discrimination and EOI obligations. Breaches of this type of regulation (as compared to, for example, regulation requiring BT to publish price lists or maintain a particular maximum price) are by their very nature difficult both to detect and assess. The regulation of BT Openreach is currently not fully effective, and the merged entity would have the ability and an enhanced incentive to engage in foreclosure strategies in the future. There is therefore a merger-specific effect on the basis of the test used in paragraph 18.31 of the

PFs where the CMA acknowledges that a merger-specific effect will arise in cases where the merger does not increase BT's ability to foreclose but "we thought that BT was not fully exploiting whatever ability it had to harm its rivals and the merger substantially increased BT's incentive".

The CMA has also incorrectly relied on Ofcom's proposal in the 2016 BCMR to regulate the price difference between EAD and EAD LA when it is not sufficiently certain that this proposal will be implemented.

#### **Backhaul: BT Wholesale input foreclosure strategies**

- (iii) **Foreclosure by BT Wholesale under the current contracts:** Contrary to the CMA's PFs, BT Wholesale will be able to engage in foreclosure through denying access to innovation, increasing price and/or decreasing quality of service under Vodafone's current contract with BT Wholesale, and this would significantly affect Vodafone's competitiveness.
- (iv) [redacted]

#### **Retail Mobile**

- (v) **Unclear why BT's femtocell strategy could be replicated by other MVNOs:** It is unclear how the CMA reached the conclusion that BT's femtocell strategy could be replicated by other MVNOs given BT is the only MVNO with spectrum. If the CMA has based this conclusion on the possibility of other MVNOs bidding for and winning spectrum in future auctions, this is highly speculative when considered against the fact that BT already has a licence to use spectrum. The CMA would also not have taken into account that the forthcoming auctions of 2.3GHz and 3.4GHz spectrum will not make available any spectrum that is 4G ready. Therefore, any other MVNO that were to purchase such spectrum would be a number of years from deploying that spectrum in competition with other MNOs (whereas the spectrum that is already available to BT is 4G ready spectrum). Therefore, if there were to be any replication of BT's femtocell strategy by other MVNOs this would not be for many years and in the interim the competition from an independent BT using such a strategy would not be replicated. Moreover, no other MVNOs would be able to replicate the small cell network that BT would be able to deploy given BT's unique access not only to the largest network of customer premises equipment, but also a significant network of street furniture such as cabinets and poles that could be used for outdoor small cells, and low cost access to backhaul.
- (vi) **Incorrect analysis of spectrum:** The CMA's analysis of spectrum and capacity constraints does not fully take into account the implications of the forecasted substantial increase in mobile data traffic. It also incorrectly treats all spectrum as equivalent and has not taken into account the increased expense and reduced effectiveness of other methods of adding capacity. The CMA has therefore overestimated the ability of the other MNOs [redacted] force BT/EE to deploy that capacity. Therefore it has understated the likelihood that BT/EE will inefficiently hoard spectrum relative to the counterfactual (and the harmful effects of this hoarding on UK consumers).

## Wholesale Broadband

- (vii) **Incorrect reliance on VULA margin test when this is highly uncertain due to existence of ongoing appeals:** the CMA has not placed sufficient weight on the impact of the ongoing appeals on the effectiveness of the regulatory constraints on BT's ability to foreclose rival CPs in the context of BT's increased ability and incentives to do so, in particular with respect to fixed/mobile bundles.
- (viii) **Amending guidance or departing from guidance should be considered future regulation:** future amendments of Ofcom's guidance on the VULA margin test should be considered as only potential future regulation, not current regulation, and is insufficiently certain to be relied upon by the CMA to address the SLC arising from the merger.

## Interrelated Effects

- (ix) **Insufficient consideration of the overall effect of the proposed merger:** the CMA has given insufficient consideration to whether the proposed merger would result in an SLC 'in the round'.

1.6 Annexure 1 to this response contains Vodafone's views on other key paragraphs which contain inaccuracies.

## 2. MOBILE BACKHAUL: BT OPENREACH INPUT FORECLOSURE STRATEGIES

2.1 Vodafone disagrees with the PFs on potential input foreclosure strategies by BT Openreach for the reasons outlined below. As explained in Vodafone's previous submissions, the merger would result in BT Openreach having the ability and enhanced incentive to engage in foreclosure strategies against Vodafone and the other MNOs.

### (A) Incorrect finding of a lack of evidence of past discriminatory behaviour and incorrect reliance on that finding

2.2 The CMA's PF that it was unlikely that BT Openreach would have the ability to degrade the quality of BT Openreach Ethernet leased lines or discriminate in the development of new BT Openreach products is based on a finding that there is a lack of evidence of past discriminatory behaviour.<sup>5</sup>

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<sup>5</sup> See for example, paragraphs 16.46 to 16.48 and 16.70 to 16.74 of the provisional findings report on the anticipated acquisition by BT of EE dated 28 October 2015 ("PF Report"). See also footnote 456 of the PF Report which states: "On the other hand, if evidence shows that BT currently does not discriminate against rivals where it may have an incentive to do so, this may be evidence of an absence of ability to foreclose."

2.3 Vodafone does not agree with the CMA's finding that there is no evidence of past discriminatory behaviour by BT Openreach, for the reasons outlined in Sections 2(C), 2(D) and 2(E) below.

2.4 In any event, any alleged lack of evidence of past discriminatory behaviour indicates the difficulties of detecting and assessing such conduct, rather than BT having no ability to engage in such conduct. Breaches of regulation that prohibit a measurable and observable outcome (e.g. prohibition on pricing above a particular amount, or not providing access on request) may be easier to detect and assess. However, this is not the case for breaches of non-discrimination or EOI obligations, which, by their very nature, are extremely difficult to detect and assess. Simply because Ofcom or the EAB may not have positively found that BT has breached its non-discrimination or EOI obligation does not mean that BT has not engaged in discriminatory conduct in the past, particularly when considering the difficulty of detecting and proving such conduct, and the expense and time lag involved in doing so. By way of illustration:

- (i) In the dispute Vodafone referred to Ofcom regarding deemed consent<sup>6</sup>, Ofcom has provisionally concluded that several categories of behaviour by BT in relation to the use of 'deemed consent' are not in accordance with BT's SMP obligations and/or the terms of its Connectivity Service Agreement. This finding has only occurred after Vodafone has investigated and audited BT's use of 'deemed consent' for a representative sample of months at considerable expense, and in a context where the conduct occurred from 1 September 2012 to 31 January 2014 (i.e. from more than three years ago).<sup>7</sup> This demonstrates that BT has in the past been able to circumvent the current regulation due to the difficulties of detection.
- (ii) Another example is in BT Openreach's treatment of EAD "tail" orders, which BT Openreach defines as circuit orders taking over 159 working days to complete. This 159 working day period is an arbitrary threshold determined by BT, and these orders are simply indicative of the overall backlog of work. Service Level Guarantees will fall far short of compensating for these orders (whether or not "deemed consent" has been used) since these payments are capped at 60 days.

Vodafone orders currently constitute approximately [redacted]% of BT Openreach's total EAD tail orders, despite Vodafone's EAD orders making up only approximately [redacted]% of BT Openreach's total EAD order throughput.

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<sup>6</sup> See further Ofcom Letter, paragraph 1.8(iii)(b) and Annex 1.

<sup>7</sup> Ofcom's provisional conclusions are available at: [http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01165/](http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01165/).

The fact that a highly disproportionate volume of Vodafone orders are being delayed by over 159 working days suggests potential discrimination by BT Openreach. This is likely to increase post-merger once BT has the enhanced incentive to engage in such behaviour. There is no transparency over BT Openreach's process or methodology for prioritising orders so the merged entity could prioritise the completion of its own orders without the other MNOs being able to detect this. There is clearly ample scope for BT Openreach to discriminate in this respect, and other similar areas where detection or monitoring of potential breaches is difficult.

- (iii) In addition, in some cases even where detection is possible, it is very difficult for third parties and/or regulators to make a conclusive assessment. Ofcom's non-determinative conclusions in relation to Project Services is a clear example of this, where Ofcom found no evidence that Project Services received favourable treatment, but was equally unable to exclude this possibility (see further paragraphs 2.27 to 2.28).

These examples clearly demonstrate that Vodafone's concern about BT's ability to discriminate and the difficulty of detecting and assessing such discrimination is far from hypothetical.

- 2.5 In any event, Vodafone also does not agree with the approach of assuming there is no ability to foreclose on the basis that there is allegedly not more evidence of BT engaging in past discriminatory behaviour. This approach is flawed because it does not take into account the significant increase in BT's incentive to engage in foreclosure strategies due to the merger. The CMA has itself acknowledged that while in the counterfactual BT would have had some incentive to foreclose downstream MNOs, the scale of EE's mobile business means that the merged entity is considerably more likely to benefit from harm to other MNOs and therefore it is plausible that the merger could increase the merged entity's incentive to foreclose MNOs.<sup>8</sup>
- 2.6 In these circumstances where BT Openreach would have a greater incentive to engage in foreclosure strategies post-merger compared to pre-merger, any alleged lack of prior discriminatory behaviour cannot be used to assume that BT Openreach would not have the ability to engage in foreclosure strategies post-merger. This is consistent with the CMA's acknowledgment in paragraph 18.31 of the PF Report that there may be a merger-specific effect where BT was not fully exploiting whatever ability it had to harm its rivals and the merger substantially increased BT's incentive. For the reasons Vodafone has previously provided in its submissions, Vodafone considers that

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<sup>8</sup> PF Report paragraph 16.5. The CMA has also acknowledged that functional separation does not necessarily exclude BT's incentives to foreclose (see PF Report paragraph 16.15).

regulation is not currently fully effective to deny BT the ability to engage in foreclosure strategies and the merger substantially increases BT's incentive to exploit this post-merger.

**(B) Incorrect reliance on existing and future regulation**

*Incorrect reliance on existing regulation*

2.7 The CMA's PFs in relation to BT Openreach rely heavily on BT's ability to foreclose being constrained by the existing non-discrimination and EOI obligations. It is notable that, rather than relying on the charge control or other prescriptive regulation, the CMA has relied on the general obligations of non-discrimination and EOI as constraining BT's ability to foreclose, which, as discussed in Section 2(A), are extremely difficult to detect and assess. For example:

- (i) The CMA's PF that it is unlikely that BT Openreach would have the ability to increase the price of Openreach Ethernet leased lines is based on a finding that this would be in breach of BT's SMP condition of non-discrimination.<sup>9</sup> While the CMA's PF mentions the constraints imposed by the charge control<sup>10</sup>, the CMA does not actually find that any of the concerns raised by Vodafone and Sky would be in breach of the charge control, but relies instead on the non-discrimination obligation.
- (ii) The CMA's PF that it was unlikely that BT Openreach would discriminate in the development of new Openreach products is based on a finding that CPs have the right to appeal to Ofcom if they think they have been discriminated against in the treatment of an SoR.<sup>11</sup>
- (iii) The CMA's PF in relation to other strategic decisions taken by BT Openreach is based on the finding that the deployment of fibre infrastructure in a way that directly discriminates against rival MNOs would be considered a breach of the EOI requirement.<sup>12</sup>

2.8 If the CMA were to consider whether potential foreclosure strategies are unlawful, it should take this into account when assessing the merged entity's incentives to engage

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<sup>9</sup> PF Report paragraphs 16.34 and 16.36, and Appendix K paragraphs 116, 119 and 121.

<sup>10</sup> PF Report paragraphs 16.39.

<sup>11</sup> PF Report paragraphs 16.73 and 16.74.

<sup>12</sup> PF Report paragraph 16.78(c).

in such conduct as opposed to its ability to do so and should consider in this analysis the likelihood of detection and the potential consequences of such behaviour. BT/EE has the ability to engage in conduct, even where such conduct may breach the law (such as an SMP condition or general competition law such as the prohibition on abuse of dominance). The Merger Assessment Guidelines indicate that the CMA may consider how unlawfulness of behaviour may impact on the incentive to carry out the behaviour, but this is not the analysis that the CMA has conducted in the PFs.<sup>13</sup> In this regard, Vodafone notes that the Merger Assessment Guidelines state at paragraph 5.6.14:

*In certain situations, foreclosure may involve behaviour that is unlawful under competition law. In assessing how this might impact on the incentive to carry out the behaviour in question, the Authorities may take into account whether the behaviour would be clearly, or highly probably, unlawful; whether the behaviour would be likely to be detected; and the potential consequences of such behaviour (eg enforcement action taken by the OFT).<sup>14</sup>*

2.9 The CMA has not taken into account whether the behaviour would be likely to be detected, or analysed fully the potential consequences of such behaviour. There is a high risk that behaviour which breaches the non-discrimination or EOI obligation will be difficult to detect and may not be subject to enforcement action taken by Ofcom, either at all or in a meaningful timeframe. This is because:

- (i) As discussed in Section 2(A) above, discriminatory behaviour is difficult to detect and prove. It is time consuming and expensive for MNOs to prepare a complaint or formal dispute to Ofcom, and in some circumstances MNOs may not have all the required information given the information asymmetry between BT and third parties.<sup>15</sup> For example, in preparing its dispute regarding the use of “deemed consent” by BT to avoid SLG payments for Ethernet services, Vodafone had to undertake a detailed and time-consuming analysis of the application of “deemed consent” which took [redacted] of negotiation with BT before the dispute was referred to Ofcom. Ofcom has taken approximately 2 months to reach a provisional conclusion, and it still requires further correspondence with BT to apply the final decision by Ofcom to Vodafone’s orders. This was in a context in which BT rejected Vodafone’s proposal to apply the proportion of inappropriate “deemed consents” identified by Vodafone from a sample of three months across the whole relevant period, even though it

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<sup>13</sup> The PFs find that the regulations deny BT the ability. Vodafone submits that this is not the correct approach.

<sup>14</sup> *Merger Assessment Guidelines CC2/OFT1254*, September 2010, paragraph 5.6.14.

<sup>15</sup> [redacted]

would be highly expensive for Vodafone to manually investigate every month during the period and BT has an obligation to proactively assess and pay compensation. Vodafone notes that Ofcom was aware that deemed consent was being used by BT and could have investigated BT Openreach's compliance with its regulatory obligations at any time, but did not.

- (ii) Vodafone has brought a number of concerns to the attention of Ofcom and the CMA about BT's behaviour and the effectiveness of the regulatory regime.

However, even if a third party incurs the expense and time required to prepare a complaint, there is no guarantee that Ofcom will investigate the complaint. Ofcom decides whether or not to open investigations on a case-by-case basis and decides whether conducting an investigation would be consistent with its administrative priorities.<sup>16</sup> It is therefore possible that Ofcom will not take enforcement action even where the behaviour breaches an SMP obligation.

2.10 There is also often a significant time lag between the conduct, the date a dispute is brought to Ofcom, and the outcome of any dispute or enforcement action. For example, Ofcom has only recently provisionally concluded that several categories of behaviour by BT in relation to the use of "deemed consent" are not in accordance with BT's SMP obligations and/or the terms of its Connectivity Service Agreement, when the conduct started more than three years ago.

2.11 In this regard, Vodafone notes that there is also significant uncertainty as to the extent of Ofcom's powers to impose retrospective payments on BT (such as repayment of any overcharge by BT and interest on such repayment) when resolving disputes. This is because BT is currently appealing a decision of the Competition Appeal Tribunal in relation to Ethernet in the Court of Appeal ("**Ethernet Appeal**").<sup>17</sup> Vodafone does not have access to the appeal documents in the Ethernet Appeal, but understands that one of the grounds for BT's appeal is that Ofcom does not have the power to impose retrospective payments on BT when resolving disputes.<sup>18</sup> Vodafone notes that BT's appeal is essentially challenging Ofcom's ability to order repayments to rectify a breach,

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<sup>16</sup> Ofcom Enforcement Guidelines, 25 July 2012, paragraphs 4.11 to 4.13.

<sup>17</sup> *British Telecommunications PLC v Office of Communications & Others*, Case reference C3/2014/4203.

<sup>18</sup> See paragraph 5.105 of Ofcom's final determination on the disputes between BT and each of Gamma and Vodafone in relation to BT's average porting conveyance charges dated 11 November 2015 (available at: [http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01161/Final\\_Determination.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01161/Final_Determination.pdf)). See also paragraphs 63 to 67 of *British Telecommunications plc; Cable & Wireless Worldwide plc & Others; British Sky Broadcasting Limited & Others v Office of Communications* [2014] CAT 21.

even where BT has been found to have over-charged in breach of its obligations. This demonstrates BT's approach to its regulatory obligations.

- 2.12 This uncertainty is already having an effect on Ofcom's determinations on disputes. For example, in Ofcom's recent final determination of the disputes between BT and each of Gamma and Vodafone in relation to BT's average porting conveyance charges, Ofcom concluded that BT overcharged Gamma and Vodafone and should make repayments to Gamma and Vodafone for the amount of the overcharge with interest. However, in relation to both the interest payments and the repayments covering the period prior to the disputes being brought to Ofcom, BT will not be required to make those payments until the judgment in the Ethernet Appeal in the Court of Appeal is handed down (which is not expected until spring 2017 and it is possible the judgment will be further appealed), and then only if the judgment confirms Ofcom's power to order such repayments and interest.<sup>19</sup>
- 2.13 If BT's appeal is successful, it would significantly restrict Ofcom's powers to impose retrospective payments on BT, which significantly reduces the consequences BT faces for a breach of its SMP obligations, and therefore creates obvious incentives to engage in such behaviour, especially where such behaviour makes it more difficult for downstream rivals to compete. Vodafone notes that there is often a significant time lag of typically several months between when a dispute is first raised with BT and when the dispute is referred to Ofcom because the parties negotiate to try to resolve the dispute and Ofcom will generally only accept disputes when resolution of the dispute using alternative means (e.g. negotiation) has failed.<sup>20</sup>

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<sup>19</sup> See, for example, paragraphs 1.13 and 5.105 to 5.110 of Ofcom's final determination. Vodafone notes that Ofcom completed a review of Average Porting Conveyance Charges and decided not to put in place specific charges for fixed (unlike for mobile), and instead outlined guidelines for the basis of charges to be applied by fixed operators. At the time, Vodafone pointed out to Ofcom that this would likely result in a dispute. Subsequently, Vodafone and Gamma referred a dispute relating to BT's charges to Ofcom. Ofcom concluded that BT had overcharged Gamma and Vodafone, and has commenced an own initiative investigation into BT's apparent non-compliance with General Condition 18.5, which requires that porting charges be reasonable and based on the incremental costs of providing portability (see [http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01172/](http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01172/)). Vodafone notes that this could have been avoided had specific charges been set instead of guidelines. Vodafone will not be able to receive the amount it has been overcharged and interest for the period prior to the dispute being brought to Ofcom until at least spring 2017, and then only if BT does not win its case on retrospective payments.

<sup>20</sup> For example, in the case that is the subject matter of the appeal, Sky/TalkTalk first raised a dispute with BT in January 2008, while the charges complained of were still current, but made a formal reference of the dispute to Ofcom only on 27 July 2010. Virgin disputed the charge with BT in October 2007, but referred the dispute to Ofcom on 10 August 2010. In those cases, and in the cases of CWW and Verizon, the disputes were referred to Ofcom after the period of alleged overcharging had ended. See *British Telecommunications plc; Cable & Wireless Worldwide plc & Others; British Sky Broadcasting Limited & Others v Office of Communications* [2014] CAT 14 paragraph 249.

- 2.14 If BT wins this case on retrospective payments, then it has obvious incentives to game and frustrate the regulatory system, because the *ex post* enforcement of regulatory obligations is very clearly ineffective. Even if the courts finally reject BT's argument that Ofcom cannot award retrospective payments, whether in the UK or EU courts, the saga demonstrates BT's ability and incentive to frustrate regulation by liberal and aggressive use of appeals, and threats thereof. The CMA has not considered the impact of this in its analysis.
- 2.15 Furthermore, in paragraph 18.31 of the PF Report, the CMA has acknowledged that where regulation is not currently fully effective, there may be a merger-specific effect if BT was not fully exploiting whatever ability it had to harm its rivals and the merger substantially increased BT's incentive. For the reasons outlined in Vodafone's previous submissions, the regulation of BT Openreach is not currently fully effective, BT Openreach may not be fully exploiting its ability to harm its rivals and the merger substantially increases BT's incentive to do so. The CMA has simply relied on general obligations such as the non-discrimination and EOI obligations without assessing how effective these regulations are, the difficulty of detecting and assessing breaches of such regulation, and the increase in BT's incentive to harm rivals resulting from the merger. To simply rely on non-discrimination and EOI obligations to dismiss a finding of SLC would run counter to the purpose of merger control, which is to prevent a market structure arising that would result in an SLC.

*Incorrect reliance on future regulation*

- 2.16 The CMA has referred to the fact that Ofcom has proposed in the 2016 BCMR to require that the price difference between EAD and EAD LA be equal to the LRIC of EAD. The CMA has stated that, if implemented in its currently proposed form, this regulation would eliminate any ability of increasing rivals' costs by altering the relative prices of EAD LA and EAD and would prevent any discrimination based on the required length of backhaul links.<sup>21</sup> The fact that Ofcom is considering this proposal is, in itself, evidence that BT has the ability to discriminate.
- 2.17 The CMA cannot take into account Ofcom's 2016 BCMR proposals in its review of the BT/EE merger because these are still in consultation and there is no certainty as to whether and to what extent the proposal will eventually be adopted. By definition and indeed as a matter of law, the proposals in the current BCMR consultation are in the "*formative stage*" only.<sup>22</sup> The CMA has in paragraph 18.74 of the PF Report stated that in respect of new regulation, it would consider first whether that future regulation is more

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<sup>21</sup> PF Report Appendix K paragraphs 117 and 122.

<sup>22</sup> See *R (on the application of Moseley (in substitution of Stirling Deceased)) v London Borough of Haringey* [2014] UKSC 56.

likely than not to come into force (and that no SLC arises between completion of the merger and such future regulation coming into force) and secondly whether such regulation would be effective. Given it is not clear whether or when the 2016 BCMR proposals will come into force and such proposals are in the formative stage only as a matter of law, even on the CMA's test, it is therefore incorrect for the CMA to place any reliance on the 2016 BCMR proposals in its determination of whether an SLC arises upon completion of the merger.

**(C) Strategy 1 – Foreclosure by increasing the price of Openreach Ethernet leased lines**

- 2.18 The CMA has provisionally found that the merged entity was unlikely to have the ability, by increasing the price of Openreach Ethernet leased lines, to significantly increase rival MNOs' backhaul costs for the following three reasons:
- (i) The constraints imposed by the charge control;
  - (ii) The small incidence that backhaul has on MNOs' costs; and
  - (iii) The lack of a clear link in the short run between the actual price paid by MNOs for backhaul and the prices of the BT Openreach products.<sup>23</sup>
- 2.19 Vodafone does not agree with this PF for the reasons outlined below.
- 2.20 In relation to the first reason, for the reasons outlined in Section 2(B), the CMA cannot dismiss BT Openreach's ability to pursue this foreclosure strategy simply on the basis that it would be a breach of the SMP condition of non-discrimination.
- 2.21 The merging parties have told the CMA that the SMP condition of non-discrimination generally means that a price change for a standard variant of a particular EAD product would have to be accompanied by a corresponding price cut for the LA version, unless BT Openreach had an objective justification for the difference.<sup>24</sup> In response to this assertion, Vodafone has conducted an analysis of the historic pricing of EAD and EAD LA (provided at Annexure 2). This empirical evidence indicates that BT has the ability to change the differential between its EAD and EAD LA products without prompting investigation by Ofcom as to whether this would breach the SMP condition of non-discrimination. Although Vodafone notes that the prior occasions on which BT has done this have involved reducing the difference in price between the products, this

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<sup>23</sup> PF Report paragraph 16.39.

<sup>24</sup> PF Report Appendix K paragraph 116.

nonetheless shows that post-merger, when BT will have the enhanced incentive to discriminate against rival MNOs, it will be able to manipulate the pricing differential to its advantage. Therefore, the CMA cannot rely on the constraints imposed by the charge control and SMP conditions to exclude the possibility of BT/EE having the ability to discriminate in relation to the pricing of Openreach Ethernet leased lines post-merger.

- 2.22 In relation to the second reason, while backhaul is a small proportion of MNOs' costs, the CMA has found that in terms of MNOs' profits, backhaul costs are not insignificant.<sup>25</sup> As Vodafone has outlined in the response to question 40 of the Phase 2 Questionnaire, [redacted]. These factors have not been considered in the CMA's analysis of the impact of an increase in BT Openreach prices.
- 2.23 The third reason refers to the fact that the pricing under MNOs' contracts with BT Wholesale does not closely link MEAS prices to the underlying prices of BT Openreach products.<sup>26</sup> The CMA has acknowledged that [redacted].<sup>27</sup> [redacted]. Therefore, the third reason should not apply to Vodafone.

**(D) Strategy 2 – Foreclosure by discriminating on the quality of Openreach Ethernet leased lines**

- 2.24 The CMA has provisionally found it is not likely that the merged entity would have the ability to degrade the quality of mobile backhaul it supplies to competing MNOs through Openreach. The sole reason provided for this PF is that the CMA did not find evidence to support third party concerns that BT had in the past circumvented existing regulation.<sup>28</sup> Vodafone does not agree with this PF and considers that this is a flawed approach for the reasons provided in Section 2(A). In addition, for the reasons outlined below, Vodafone considers there is evidence that BT had in the past circumvented existing regulation.

*Provision times*

- 2.25 As the CMA has acknowledged in paragraph 16.47(a) of the PF Report, BT's EAB reports for 2013, 2014 and 2015 indicated that the percentage of EAD orders fulfilled on time for BT divisions was consistently higher than those for third parties. The CMA then states that "*Ofcom found that, when the initially stipulated completion date was*

<sup>25</sup> PF Report footnote 457.

<sup>26</sup> PF Report paragraph 16.38.

<sup>27</sup> PF Report Appendix K paragraph 123.

<sup>28</sup> PF Report paragraph 16.48.

*considered and delays due to customers' behaviour were excluded, there was no evidence of systematic bias in favour of BT.*"<sup>29</sup> There are a number of issues with this conclusion:

- (i) As the CMA has acknowledged in footnote 57 in Appendix K, Ofcom's finding in the BCMR May 2015 consultation was that they did not consider there is evidence of systematic bias "*with the possible exception of Category 4 orders*".<sup>30</sup> Even if Category 4 orders constituted fewer than 5% of all orders, this suggests that there is evidence of systematic bias by BT for some orders and the CMA cannot use the BCMR May 2015 consultation findings to support its conclusion that there is no evidence of past discriminatory behaviour. As discussed in further detail in Section 2(A) above, BT may not be fully exploiting whatever ability it had to harm its rivals pre-merger but the merger substantially increases BT's incentive to do so.
- (ii) Table A17.24 of the BCMR May 2015 consultation shows the proportion of orders changed by deemed consent for BT divisions versus other CPs (after excluding customer caused delays). Deemed consent is a contractual process that allows BT Openreach to deem that a CP has consented to an extension of the Contractual Delivery Date (even where no actual consent has been provided). Orders that are subject to deemed consent are reported as fulfilled on time if the orders are delivered by the extended Contractual Delivery Date. As a result, no compensation is payable despite the order being delivered after the initially stipulated completion date.

This table shows that in every category and year analysed, except for two (Category 3 orders for 2013 and 2014), the proportion of orders changed using deemed consent for other CPs was higher than BT. It is unclear why this is not evidence of systematic bias by BT for using deemed consent for orders more often for other CPs compared to BT divisions. This indicates that BT used the deemed consent process to extend the delivery date, without having to pay any compensation, for orders of other CPs more often compared to BT divisions.

- (iii) The BCMR May 2015 consultation was published prior to the dispute raised by Vodafone relating to BT's use of 'deemed consent'. Ofcom has recently provisionally concluded that several categories of behaviour by BT in relation to the use of 'deemed consent' are not in accordance with BT's SMP obligations

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<sup>29</sup> PF Report paragraph 16.47(a).

<sup>30</sup> BCMR May 2015 consultation paragraph A17.163.

and/or the terms of its Connectivity Service Agreement.<sup>31</sup> Vodafone considers that BT has engaged in such behaviour systematically and its analysis presented in the dispute has revealed extensive evidence of systematic misuse of “deemed consent” by BT with respect to Vodafone.<sup>32</sup> Ofcom has on 6 November 2015 also opened an own-initiative investigation into BT’s use of “deemed consent” in relation to the provision of Ethernet Services during the period from 1 September 2012 to 31 December 2014.<sup>33</sup>

- 2.26 Vodafone therefore considers that there is very clear evidence of past discriminatory behaviour by BT Openreach with respect to provision times for EAD, which the CMA cannot simply ignore.

#### *Project Services*

- 2.27 In relation to the disproportionate use by BT divisions of Project Services, Vodafone agrees with the CMA’s statement that “*performance differences in service provision due to the purchase of project management from Openreach could be considered evidence of discriminatory behaviour.*”<sup>34</sup> However, the CMA then relies on the fact that Ofcom did not find evidence that Project Services orders received favourable treatment in the BCMR May 2015 consultation. The CMA should not rely on this to conclude that Project Services do not receive favourable treatment for the following reasons:

- (i) Ofcom has not excluded the possibility that Project Services orders received favourable treatment (as the CMA itself acknowledges in paragraph 16.47(b) of the PF Report). Ofcom did not consider there is evidence that Project Services orders received favourable treatment “*given the evidence that is available*”. This is an important caveat because Ofcom acknowledges that orders placed with Project Services are on average likely to be more complex so evidence of similar or slightly worse performance does not necessarily rule out the possibility that such orders are expedited or receive relatively higher quality of service in other aspects of the provisioning process such as certainty of the contractual delivery date. However, Ofcom did not have sufficient data to

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<sup>31</sup> Ofcom’s provisional conclusions are available at: [http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01165/](http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01165/).

<sup>32</sup> See further the dispute previously provided to the CMA as Annex 1 to Ofcom Letter.

<sup>33</sup> [http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01170/](http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01170/).

<sup>34</sup> PF Report Appendix K paragraph 129.

estimate the counterfactual performance for an order had it not been provisioned under Project Services.<sup>35</sup>

Ofcom also found that Category 4 orders placed via Project Services appear to receive consistently lower lead times over the period investigated compared to non Project Services orders.<sup>36</sup>

Given this, the CMA cannot rely on Ofcom's findings to exclude the possibility that Project Services receive favourable treatment.

- (ii) The CMA has also not sufficiently considered the EAB's findings on Project Services. The CMA has acknowledged that the EAB reports suggest that part of the difference in the timeliness of provision might be due to the fact that BT divisions purchase a higher volume of 'project managed services' with their orders.<sup>37</sup> The CMA has not then taken into account the statement in the 2015 EAB report that "[t]he use of project services removes some of the reasons for order failure and this has had the effect of improving BT CP performance."<sup>38</sup> This is positive evidence that Project Services improves BT CP provisioning performance and should be relied on over Ofcom's findings where Ofcom could not exclude the possibility that Project Services orders received favourable treatment.<sup>39</sup>
- (iii) In the EAB's response to Ofcom's Digital Communications Review Consultation, the EAB has stated that "*some CPs have raised the fact that financial transactions between Openreach and the rest of BT are internal ("Wooden Dollars") and therefore of lesser impact on BT than the cash flows that external CPs must incur. A frequently quoted example is Project Services offered by Openreach to expedite Ethernet orders. In the current functional separation model the remedy for this is the regulation of prices for Significant Market Power (SMP) products and services*"<sup>40</sup> (emphasis in underline). This response is signed by the EAB members (including a BT Executive Member), and

<sup>35</sup> BCMR May 2015 consultation, paragraph A17.160.

<sup>36</sup> BCMR May 2015 consultation, paragraph A17.158.

<sup>37</sup> Provisional Findings Report Appendix K paragraph 128.

<sup>38</sup> EAB Annual Report 2015, page 20.

<sup>39</sup> Further information about Vodafone's views on Project Services are provided on page 67 of Vodafone's response to the BCMR May 2015 consultation, which was provided to the CMA as Annex 3 to Ofcom Letter.

<sup>40</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/dcr\\_discussion/responses/Equality\\_of\\_Access\\_Board.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/dcr_discussion/responses/Equality_of_Access_Board.pdf), paragraph 12(d).

indicates that: (i) the EAB (including a BT Executive Member) considers that Project Services are offered to expedite Ethernet orders; and (ii) the EAB suggests that this issue relating to Project Services is an area that Ofcom should consider in whatever future model is employed.

- 2.28 Vodafone therefore considers that there is clear evidence that Project Services does improve provisioning performance, which the CMA has ignored in favour of a finding of Ofcom that, in fact, explicitly stated the evidence does not rule out the possibility that orders with Project Services are expedited or received relatively higher quality of service in other aspects of the provisioning process. The CMA also appears to have ignored Ofcom's finding that there is evidence that Category 4 orders placed via Project Services receive consistently lower lead times. Given the evidence that Project Services does improve provisioning performance, on the CMA's own reasoning in paragraph 129 of Appendix K, this should be considered evidence of discriminatory behaviour.

#### *Fault repairs*

- 2.29 In relation to fault repairs, the CMA has relied on Ofcom's finding that Ethernet repair performance had generally been maintained at a good level since 2011.<sup>41</sup>
- 2.30 Simply because Ethernet repair performance is allegedly at a good level does not mean that BT has not circumvented the non-discrimination and EOI obligations in relation to fault repairs. In any event, Vodafone considers that this finding is in part due to the way in which the statistics are generated and the inclusion of faults termed as Right When Tested (i.e. faults which come into BT Openreach's Customer Management Centre and are turned away without any action being taken and without an engineering visit). Since BT does not believe that this category of faults are indeed faults, then they should also not be included in the fault repair statistics as no repair has occurred; to include these artificially inflates BT Openreach's repair performance. Once faults classed as Right When Tested are excluded, BT Openreach's repair performance is between 70% and 80% rather than at around 90%.<sup>42</sup>
- 2.31 The CMA has also referred to Ofcom's view that the fault rate is not high enough for delay to have a material impact on an MNO's retail offer.<sup>43</sup> In the BCMR May 2015 consultation, Ofcom found that fault reports as a percentage of installed volumes was

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<sup>41</sup> PF Report paragraphs 16.47(c) and Appendix K paragraph 131.

<sup>42</sup> This is discussed in greater detail in Vodafone's response to the BCMR May 2015 consultation (provided to the CMA as Annex 3 to Ofcom Letter).

<sup>43</sup> PF Report paragraph 16.23 and Appendix K paragraph 100.

7.4% in 2013/14.<sup>44</sup> Even a fault rate of 7.4% is sufficient to have a material impact on Vodafone's retail offer, as this is likely to substantially damage customer perceptions of the quality of Vodafone's network. In addition, the current fault rate is likely to increase post-merger once BT has an enhanced incentive to discriminate against MNOs other than EE by, for example, being slow to replace fault-prone equipment (as well as reducing the repair rate).

**(E) Strategy 3 – Foreclosure through frustration of innovation by Openreach or through Openreach's investment decisions**

*Concerns relating to the development of small cell infrastructure*

2.32 The CMA has provisionally found that “*it was unlikely that the merged entity would be able to pursue a foreclosure strategy that would prevent other MNOs from also deploying small cells*”.<sup>45</sup> Vodafone does not agree with this conclusion for the following reasons:

- (i) As the CMA notes, small cells require not only a physical location but also a means of backhaul to convey mobile traffic to and from the core network.<sup>46</sup> Indeed, the ability to provide cost-effective backhaul at a relevant location where there is a local traffic peak is likely to be a more critical factor for small cell selection than the availability of alternative physical locations. In this respect, BT/EE's stock of locations have an inherent advantage since they are already points of telecommunication. Other prospective locations without this facility will require additional capital investment to link the site to the nearest point of connection, and in most cases it is to be expected that the nearest point of connection will be a BT location. To expect that an alternative provider to BT would be able to provide a backhaul link at a lower cost than BT relies on an assumption of the pre-existence of such a link for a different purpose.
- (ii) Vodafone agrees with the concerns raised by Sky in relation to small cells. Vodafone considers that the merged entity will have an incentive to design its fibre infrastructure so as to limit any spare fibre that might be available to a rival MNO (other than EE) in order to restrict rival MNOs' small cell deployment. This means that the rival MNO would incur Excess Construction Charges, which would make the small cell uneconomical, given that it is provided to maintain quality of service rather than coverage and is therefore an overhead to the

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<sup>44</sup> See BCMR May 2015 consultation Table A17.25.

<sup>45</sup> PF Report paragraph 16.64.

<sup>46</sup> PF Report, paragraph 16.56.

MNO's cost base. It is unclear why MNOs having access to alternative sites (other than those owned and operated by BT Openreach) for small cell deployment would address this concern.<sup>47</sup>

- 2.33 Furthermore, the CMA observation that the future development of small cell networks is recognised by all MNOs as important to address the expected increase in mobile data traffic<sup>48</sup> is somewhat inconsistent with its argument in Appendix G, where small cells are considered to be one of the ways in which MNOs with spectrum shortage might be able to partially offset the spectrum advantage of BT/EE:
- (i) If all operators (including BT/EE) are expected to invest in small cells then the ability of Vodafone, O2 and 3 to use them to offset BT/EE's spectrum advantage is fatally undermined.
  - (ii) Vodafone, O2 and 3 will likely need to make use of small cells earlier than BT/EE, and any capacity advantage they might be able to obtain from this will be restricted as a result of the high cost of providing this capacity compared to additional spectrum<sup>49</sup> and BT/EE's ability to match the deployment with its own lower cost small cell roll out.
- 2.34 As such, given other MNOs will require small cells earlier than BT/EE, BT/EE would have the ability and increased incentive to frustrate or delay the development of infrastructure for small cells through BT's preferential site locations and backhaul capability. This will increase the costs of the other MNOs, reduce the quality of their retail offering, and reduce their competitiveness at the retail level, therefore resulting in a SLC in the retail mobile market.

*Concerns relating to Cloud-RAN*

- 2.35 The CMA has acknowledged that Cloud-RAN is a way for "MNOs to address the challenge of providing adequate capacity to meet users' increasing demand for data", that "is particularly useful to MNOs that experience spectrum related capacity constraints" and that "this technology may be more beneficial to rival MNOs than to the merged entity's mobile division".<sup>50</sup> Therefore, BT/EE would have less need for Cloud-

<sup>47</sup> The CMA considers that a key component of this foreclosure strategy would be that MNOs could not use alternative sites (other than those owned and operated by BT Openreach) for small cell deployment. See PF Report paragraphs 16.61 to 16.64.

<sup>48</sup> PF Report paragraph 16.56 (emphasis added).

<sup>49</sup> See further Vodafone's letter dated 12 August 2015, Section 3.

<sup>50</sup> PF Report paragraphs 16.65 to 16.67.

RAN compared to other MNOs, given the asymmetry in the holding of capacity-providing spectrum. As the CMA has acknowledged, Cloud-RAN requires very low latency, which is not provided by current Ethernet services, and it could only be supported by either dark fibre or other new active products that are currently being developed by BT Openreach.<sup>51</sup>

2.36 However, the CMA has provisionally found that the merged entity is unlikely to be able to harm rival MNOs by foreclosure with respect to Cloud-RAN.<sup>52</sup> Vodafone does not agree with this PF for the following reasons:

- (i) The CMA suggests that there are alternatives to Cloud-RAN, since “*efficiency benefits and capacity uplift can also be delivered by the technology upgrades from LTE to LTE-Advanced*”.<sup>53</sup> It is not clear to Vodafone what the CMA is alluding to here. The most significant feature of LTE-Advanced over first generation LTE is carrier aggregation, i.e. the ability to use an increasing volume of spectrum to service customer demands. However, this is exactly where the merged entity has an advantage; EE is already implementing LTE-Advanced. How MNOs with less spectrum can benefit from LTE-Advanced as an alternative to Cloud-RAN is not obvious when Cloud-RAN is in part a response to spectrum-related capacity issues.
- (ii) The CMA suggests that Cloud-RAN would be used especially in urban areas and notes that “*EE told the CMA that even in countries where dark fibre was widespread, Cloud-RAN had been used only in certain areas. In urban areas alternative providers of backhaul are usually available*”.<sup>54</sup> It is not clear to Vodafone that it follows from this that there would be an alternative to BT Openreach in the UK. The essence of Cloud-RAN is that in effect moving certain intelligent elements of the cell site back towards the core allows a more effective wide-area utilisation of spectrum. However, as such it could only be implemented at a regional level, and would require all cell sites in a given area to be equipped with low latency high capacity fibre at an economical cost. Whilst suppliers other than BT Openreach may be able in due course to provide such links at some cell sites, it is likely that only BT Openreach would be able to provide the capability across a wide area as required to deploy Cloud-RAN.

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<sup>51</sup> PF Report paragraph 16.65.

<sup>52</sup> PF Report paragraph 16.68.

<sup>53</sup> PF Report paragraph 16.67(a).

<sup>54</sup> PF Report paragraph 16.67(b).

- 2.37 As such, given other MNOs will require Cloud-RAN earlier than BT/EE, BT/EE would have the ability and increased incentive to frustrate or delay the implementation of Cloud-RAN through frustrating the development of backhaul products supporting Cloud-RAN technologies. This will increase the costs of the other MNOs, reduce the quality of their retail offering, and reduce their competitiveness at the retail level, therefore resulting in a SLC in the retail mobile market.

*Concerns relating to the discrimination in the development of new Openreach products*

- 2.38 Vodafone agrees with the CMA that MNOs relying on BT Openreach's active backhaul products might be discriminated against if:

- (i) BT/EE offered mobile backhaul products more suited to the needs of its mobile division than to those of competing MNOs;
- (ii) BT/EE blocked or delayed developments in backhaul technology which would benefit competing MNOs more than its mobile division; or
- (iii) BT/EE planned the development of its fixed infrastructure in a way that favoured the needs of its mobile division.<sup>55</sup>

- 2.39 However, the CMA has provisionally found it was unlikely that the merged entity would be able to harm rival MNOs by discriminating in the development of new Openreach products. The reasons provided for this PF is that the CMA did not find evidence of BT using the SoR process to discriminate against its current rivals (which, according to the PF, suggests that BT does not have the ability to do so) and the regulatory constraints that BT would face if it attempted to do so post-merger.<sup>56</sup> Vodafone does not agree with this PF and considers that this is a flawed approach for the reasons provided in Sections 2(A) and 2(B).

- 2.40 The CMA also does not appear to have considered the concerns raised by a number of communications providers ("CPs") relating to the Statement of Requirements ("SoR") process.<sup>57</sup> For example, the CMA has not considered the evidence about the higher success rate of SoRs submitted by BT lines of business compared to other CPs. The statistics compiled by Sky indicate that BT Openreach favours BT lines of business within the SoR process: 51% of SoRs submitted by BT were delivered or in development while only 24% of the SoRs submitted by non-BT entities were delivered

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<sup>55</sup> PF Report paragraph 16.54.

<sup>56</sup> PF Report paragraph 16.74.

<sup>57</sup> See, for example, BCMR May 2015 consultation paragraphs 8.39 to 8.42.

or in development.<sup>58</sup> Ofcom has also found that the success rate for SoRs submitted by BT Openreach is far higher than average (65%) and BT Group have a higher success rate compared to other CPs (27% and 18%, respectively).<sup>59</sup> Ofcom has noted that:

*“It is likely that BT Group, have greater demand volumes making the business case more likely to succeed during Openreach’s assessment phase. CP requests, unless also wanted by BT Group, are inherently likely to have smaller demand, which will make the business case more difficult to justify.”<sup>60</sup>*

- 2.41 This highlights the inherent issue with the SoR process. The SoR process provides BT Openreach with a high level of subjectivity and discretion in its decision making, as it is able to prioritise SoRs on the basis of commercial attractiveness. The EAB itself notes that Openreach *“prioritises SoRs on the basis of potential commercial return and that, as a result, some SoRs will not necessarily be taken forward”<sup>61</sup>* and that the lack of transparency in this process *“remains a cause of industry concern”<sup>62</sup>*. Such subjectivity and discretion clearly provide it with the ability to discriminate against other downstream operators.<sup>63</sup> Given the way the decision making test is framed, BT Openreach can discriminate against other CPs which compete with BT downstream, under the guise that, unless also wanted by BT Group, the demand for the innovation wanted by the other CPs does not justify its business case. It is therefore difficult to detect and prove that BT Openreach has discriminated against another CP in the SoR process, even if it is subject to extensive monitoring.
- 2.42 In these circumstances, the conclusion that there is a *“lack of evidence of BT using the SoR process to discriminate against its current rivals”<sup>64</sup>* is incorrect. Furthermore, simply because Ofcom or the EAB has not yet determined that there has been evidence of discrimination by BT Openreach in the SoR process does not mean it has not

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<sup>58</sup> Initial Submission by Sky to Ofcom’s Strategic Review of Digital Communications (available at <https://corporate.sky.com/documents/media-center/news-releases/2015/ofcom-strategic-review-initial-submission-final-non-confidential.pdf>), p. 23.

<sup>59</sup> BCMR May 2015 consultation paragraph A27.31.

<sup>60</sup> BCMR May 2015 consultation paragraph A27.31.

<sup>61</sup> EAB Annual Report 2014, page 16.

<sup>62</sup> EAB Annual Report 2015, page 17.

<sup>63</sup> See further Vodafone’s response to Question 50 of the Phase 2 Questionnaire. See also paragraph 2.7 of Annexure 1 to this response.

<sup>64</sup> PF Report paragraph 16.74.

occurred, nor that it will not be more likely to occur post-merger, given BT's changed incentives.

- 2.43 Therefore, BT/EE would continue to have the ability to block, frustrate or delay backhaul technology which would benefit competing MNOs more than its mobile division. The merger would increase its incentive to do so. This would increase competing MNOs' costs, reduce the quality of their retail offering and reduce their competitiveness at the retail level, thereby resulting in a SLC in the retail mobile market.<sup>65</sup>

*Concerns relating to other strategic decisions taken by Openreach*

- 2.44 The CMA provisionally found that, while BT/EE might have the ability to foreclose with respect to other strategic decisions, "*it would be unlikely to have the incentive to do so*"<sup>66</sup>. While Vodafone agrees that BT has the ability to foreclose in this respect (and that this is not merger specific<sup>67</sup>), the merger increases BT's incentive to do so:

- (i) The CMA suggests that it is likely that the development of fibre infrastructure will mostly be driven by demand for SFBB, not by mobile backhaul needs, as the broadband market is much larger and more valuable than mobile backhaul.<sup>68</sup> Vodafone does not agree with this. The demands of enterprise and backhaul customers also drive the development of fibre infrastructure on an order by order basis. In particular, mobile backhaul requires higher bandwidth so it is more likely that fibre infrastructure would be rolled out for high bandwidth mobile backhaul, that could then also be used for fixed broadband.
- (ii) The CMA suggests that "*most of the new radio sites that MNOs will have to connect to fibre will be small cells*"<sup>69</sup>. It is not clear why the CMA believes this to be the case as it appears to consider in Appendix G that new build of macro sites will also be an option for spectrum constrained operators to increase capacity.<sup>70</sup> This would be inconsistent with the CMA's suggestion that building macro sites is one of the options for MNOs to attempt to offset spectrum asymmetries.

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<sup>65</sup> The CMA has itself acknowledged the possibility of this in paragraph 16.53 of the PF Report.

<sup>66</sup> PF Report paragraph 16.79.

<sup>67</sup> PF Report paragraph 16.77.

<sup>68</sup> PF Report paragraph 16.78(a).

<sup>69</sup> PF Report paragraph 16.78(b).

<sup>70</sup> Appendix G paragraph 57.

[redacted].<sup>71</sup> [redacted].

The CMA states that high traffic areas will be similar for all operators and there would be limited possibility for BT/EE to prioritise fibre deployment in areas where EE has high capacity needs but other MNOs have not.<sup>72</sup> However, the key issue is not the location of traffic density, but rather the specific location of cell sites. BT/EE has the ability to lower its incremental cost for its mobile fibre connections by routing new fibre (whether for SFBB or other purposes) very close to BT/EE mobile site locations, and thereby discriminating against other MNOs who would face a much higher connection cost if BT/EE's fibre network was not adjacent to their own cell site locations.

- (iii) The CMA suggests that “*the deployment of fibre infrastructure in a way that directly discriminated against rival MNOs would be considered a breach of the EOI requirement Openreach is subject to. MNOs could then bring a formal dispute to Ofcom*”<sup>73</sup>. Vodafone does not agree with this PF and considers that this is a flawed approach for the reasons provided in Section 2(B). It is unclear how it could be proven that BT/EE has breached the EOI requirement in circumstances where it offers equivalent access to its fibre but the concern is that it has deployed its fibre infrastructure such that it is closest to BT/EE's cell site locations.

- 2.45 Therefore, BT/EE would have the ability and increased incentive to prioritise the design of its fibre footprint to support its own mobile demand, at the expense of rival CPs (who are dependent on access to BT/EE's fibre). This will increase the costs of the other MNOs, reduce the quality of their retail offering, and reduce their competitiveness at the retail level, therefore resulting in a SLC in the retail mobile market.

### **3. MOBILE BACKHAUL: BT WHOLESALE INPUT FORECLOSURE STRATEGIES**

#### **(A) Foreclosure by BT Wholesale under the current contracts**

*Denying access to innovation*

- 3.1 Vodafone agrees with the CMA's findings that:

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<sup>71</sup> See further Ofcom Letter paragraph 5.5.

<sup>72</sup> PF Report paragraph 16.78(b).

<sup>73</sup> PF Report paragraph 16.78(c).

- (i) *“...long-term contracts with significant minimum volume obligations could raise concerns if, during the lifetime of the contract, new backhaul innovations became available (or could be developed) that might be required by rival MNOs to the merged entity.”*<sup>74</sup>
- (ii) *“Whilst BT might pre-merger have an incentive to amend contracts to allow MNOs access to these innovations (on commercial terms), post-merger BT may have an incentive to delay, refuse or otherwise offer access on worse terms to rival MNOs (for example, because doing so could give its own mobile division a competitive advantage).”*<sup>75</sup>
- (iii) *“...it was not clear that the current contractual terms would prevent BT from blocking access to such changes.”*<sup>76</sup>

3.2 With respect to phase synchronisation, the CMA provisionally found that *“the merged entity could have the ability to increase an MNO’s costs associated with the adoption of this alternative technology”* but that this *“would not be of a magnitude to significantly harm the MNO’s ability to compete in the downstream market”*, since MNOs would be able to use alternative technologies such as GPS clocks for outdoor cells.<sup>77</sup> The CMA appears to conclude this on the basis that GPS clocks can be used in outdoor cells to provide the synchronisation to bring TDD spectrum into use in macro sites and small cells, and that as the *“vast majority”* of cells are expected to be installed outdoors, then there is no problem for the other operators if BT delays the development of backhauled phase synchronisation until BT/EE needs it.

3.3 However, this is simply incorrect; in reality, GPS clocks will not always be usable in the areas where capacity constraints will arise. To address local traffic hot spots, indoor small cells will be necessary in many circumstances, but the GPS signal may very well not penetrate in these locations (as recognised by Ofcom<sup>78</sup>). Furthermore, the GPS satellites that hold the timing signals move across the sky. In many urban locations, there is a *“canyon effect”* defined by high rise buildings so that an outdoor small cell located below rooftop level may have limited or no ability to see, at all times, the GPS satellites that provides the necessary timing signal, and would therefore not be able to

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<sup>74</sup> PF Report paragraph 16.136.

<sup>75</sup> PF Report paragraph 16.137.

<sup>76</sup> PF Report paragraph 16.138.

<sup>77</sup> PF Report paragraphs 16.141 to 16.143 and Appendix K paragraph 110.

<sup>78</sup> See PF Report Appendix K paragraph 110 which states: *“According to Ofcom, the issue might be more important for indoor cells, where GPS cannot be used.”*

obtain the synchronisation data. The use of GPS clocks can therefore only be considered to be a partial work-around and not a complete substitute for a backhaul link with the required level of phase synchronisation.

- 3.4 Furthermore, Vodafone does not agree with the CMA's approach of only considering phase synchronisation and access to circuits with capacity above 1 Gbit/s. Vodafone also identified the potential innovation of dark fibre which Ofcom proposes to introduce from April 2017 [redacted].<sup>79</sup> The CMA has not considered this significant issue in its analysis of BT Wholesale's denial of access by MNOs to innovations under the current contracts.
- 3.5 As the CMA has acknowledged in paragraph 16.140 of the PF Report, it is also possible (and indeed, very likely in a market with constantly evolving technology) that an innovation may become available that MNOs are not yet aware of during the term of Vodafone's contract with BT Wholesale [redacted]. Post-merger BT would have less incentive to amend contracts to allow Vodafone access to these innovations on commercial terms, which could be of a magnitude to significantly harm Vodafone's ability to compete in the downstream market.

*Increase in price or reduction in quality of service*

- 3.6 For the reasons outlined in Vodafone's previous submissions, Vodafone does not agree with the PF that the merged entity is unlikely to have the ability to foreclose Vodafone by increasing the prices or reducing the quality of the backhaul sold to it under its current contract with BT Wholesale.
- 3.7 In particular, Vodafone does not agree that a strategy of reducing the quality of service could not significantly affect Vodafone's competitiveness. As previously explained, BT Wholesale could delay circuit deployments and repairs, and could delay the replacement of fault prone equipment, which could increase the fault rate for circuits. For example, [redacted].<sup>80</sup>
- 3.8 Even if any faults or provisioning delays that can be caused by BT Wholesale are "temporary and localised", such faults and delays may be widespread across Vodafone's network and could have a significant impact on the quality of Vodafone's retail mobile services and therefore its competitiveness, not only in the relevant local areas, but also nationwide, given the impact on the reputation of Vodafone's network nationwide. The CMA has received evidence that suggests a higher propensity to churn

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<sup>79</sup> See Ofcom Letter paragraph 2.6.

<sup>80</sup> See Vodafone's response to question 49 of the Phase 2 Questionnaire.

where customers experienced temporary congestion resulting in speeds below 400 Kbit/s.<sup>81</sup>

- 3.9 While the CMA has defined the retail mobile market as national, it has stated that “*within the competition assessment we take account of temporary local quality variations (such as slower speeds caused by site congestion) and how this may affect the closeness of competition between operators at the national level.*”<sup>82</sup> This analysis has not been done in relation to the impact of backhaul quality degradation on competitiveness. As Vodafone has previously explained, the effect of quality degradation by BT may be widespread rather than localised because BT would have the ability to degrade quality systematically across the country.<sup>83</sup> The CMA has also acknowledged that potential implications for Vodafone from delays in the delivery of a new circuit include a delay in the expansion of its 4G network [redacted].<sup>84</sup> Such delays will significantly affect Vodafone’s competitiveness at a national and local level, and it is unclear why and how the CMA has reached the opposite conclusion.

**(B) [redacted]**

- 3.10 [redacted].<sup>85</sup> [redacted].<sup>86</sup>

- 3.11 [redacted].<sup>87</sup> [redacted].<sup>88</sup>

**4. RETAIL MOBILE**

- 4.1 The CMA has provisionally concluded that the merger is not expected to result in an SLC as a result of the loss of the current and potential constraint from BT in the retail mobile market.

<sup>81</sup> PF Report paragraph 16.24.

<sup>82</sup> PF Report paragraph 10.46.

<sup>83</sup> See further TOH 4 Letter, Section 5.

<sup>84</sup> PF Report paragraph 16.173.

<sup>85</sup> PF Report paragraph 16.100(c) and Appendix K paragraph 144.

<sup>86</sup> This applies the same logic as the CMA’s provisional finding with respect to wholesale mobile that where a party did not have the ability to cause a price rise by not bidding (or in this case quality degradation) by a foreclosure strategy, it would also not have the incentive to engage in such a strategy – see PF Report paragraph 14.136.

<sup>87</sup> PF Report paragraph 16.100(c) and Appendix K paragraph 144..

<sup>88</sup> See Ofcom Letter and Letter dated 11 September 2015, and Vodafone’s response to Questions 16 and 18 of the CMA’s questions of 18 August 2015

4.2 As previously explained, Vodafone considers that post-merger, BT/EE will hoard some or all of BT's spectrum, compared to BT using its full spectrum capacity to provide a competing retail offering in the counterfactual, and this loss of the productive use of BT/EE's spectrum may be expected to result in a SLC in the UK retail mobile market.<sup>89</sup> As discussed further in paragraph 4.3 below, contrary to what the CMA appears to assume: (a) not all existing spectrum held by MNOs is readily usable for 4G and future spectrum releases will not solve the problem, except possibly in the very long term; (b) alternative means of "catching up" are much more expensive and much less timely; and (c) BT/EE's rivals will in any event be discouraged from deploying alternative means of "catching up" by the knowledge that BT/EE can equally employ such alternative means, [redacted].

4.3 Vodafone also considers that the CMA's approach to spectrum is incorrect for the following reasons:

- (i) The CMA's analysis in Appendix G of the PF Report does not fully take into account the implications of the forecasted substantial increase in mobile data traffic on the need to provide incremental capacity to support it. Ofcom has forecasted that data traffic demands, particularly on 4G, will significantly increase over the next few years. Figure 5.1 of the PF Report shows that, using the quarter to March 2015 as a baseline, Ofcom forecasts an increase of 205% by March 2016, 480% by March 2017, 795% by March 2018, and 1155% by March 2019. This traffic increase is anticipated to come from only a small increase in the number of mobile devices, and largely arises from increasing data use per active customer, increasing 4G device penetration, and increasing smartphone penetration.

Ofcom's forecast also shows only a small decline in 3G data traffic of 35% between the March 2015 and the March 2019 quarter. Therefore, it is difficult to see how substantial, rapid re-farming is possible.

Ofcom's data forecast is underpinned by an expectation of a considerable increase in average data use by the average 4G data customer over present levels. The CMA has analysed the effects of speed on competition from the perspective of present or past benchmarks.<sup>90</sup> As a result, the analysis is flawed. 4G is currently a developing technology, with the rollout of basic national coverage a major ongoing activity for all operators except EE. The

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<sup>89</sup> See in particular Initial Phase 2 Submission, Section 3; Letter dated 12 August 2015, Sections 2 and 3; and Ofcom Letter, Section 6.

<sup>90</sup> For example, Paragraphs 99 to 110 of Appendix G focus on present or past benchmarks. The observations in paragraph 25 of Appendix G are on current data traffic levels and are therefore of little long run relevance.

increase in mobile data per customer will naturally raise customer expectations of acceptable quality and current operator network minimum speed thresholds will have to rise significantly to meet such expectations: to expect that 2Mbps will continue to be an acceptable average customer speed, as EE appears to be suggesting<sup>91</sup>, cannot be consistent with the expected growth in usage, nor indeed EE's own marketing.<sup>92</sup>

The increase in data traffic demands will mean that customer busy hour traffic demands will also increase, and this can only be accommodated with a significant increase in capacity provision, which can be best achieved through additional 4G spectrum deployment. Therefore, the relevant consideration is not the present level of congestion in operators' networks, but rather the future level of congestion that may arise from the inability to provide an increase in capacity in line with the likely overall increase in consumer demand, and the increase in consumer expectations with respect to acceptable minimum speeds. Without an appropriate capacity increase operators will be unable or severely restricted in their ability to compete for and/or retain retail and wholesale customers.

- (ii) Provisioning for the increase in data traffic is most effectively accomplished by increasing the volume of usable 4G spectrum deployed at macro cell sites. This can linearly increase capacity (subject to coverage limitations) but this is only capable of contributing effectively to capacity constraints where a significant proportion of devices in the customer base are capable of using that spectrum.<sup>93</sup>

In its analysis, the CMA has not properly considered the differences between spectrum in relation to its ability to provide 4G data traffic capacity now and in the future and has produced several figures and tables which appear to consider all spectrum in general and which, as a result, understate the extent of spectrum asymmetry that the proposed transaction will significantly exacerbate.<sup>94</sup>

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<sup>91</sup> PF Report, Appendix G, paragraph 102.

<sup>92</sup> See e.g. Initial Phase 2 Submission, paragraph 3.20 and Response to CMA's Phase 1 questionnaire dated 2 April 2015, question 24.

<sup>93</sup> See e.g. Initial Phase 2 Submission, paragraphs 3.21 and 3.22; and Response to CMA Phase 1 questionnaire dated 2 April 2015, question 30.

<sup>94</sup> See e.g. PF Report, Appendix G, Figure 2 and Tables 1 and 2. Tables 1 and 2 also do not appear to mention BT spectrum. Table 3 fails to properly record current usage, showing without annotation some bands that are not in use [redacted] and other bands that are only partly used (EE's 2600MHz paired spectrum) as if they were used in full.

It is incorrect to treat all spectrum as equivalent irrespective of its present availability and usability and irrespective of the different future utility of different spectrum bands, which depends on whether and when compatible devices are manufactured and whether suitable site networks are in place for the spectrum (i.e. spectrum in higher bands has more limited propagation characteristics and may require a re-engineered grid of sites to be deployed effectively). The CMA appears to conduct much of its analysis as if the following categories of spectrum can be considered equal in 4G utility:

- (a) 4G ready spectrum, being spectrum which is held by operators, is harmonised for 4G use, is free of legacy use, and devices capable of using the band already have extensive penetration into the customer base of an operator (i.e. 800MHz, paired 2600 MHz and the spare proportion of 1800MHz owned by EE).
- (b) Spectrum that is held by operators, is not used by any legacy technology, and is capable of future 4G use, but expected device and infrastructure equipment penetration does not permit imminent effective use and the timing of such use is uncertain (i.e. 1400MHz SDL and 2600MHz unpaired<sup>95</sup>).
- (c) Spectrum that is held by operators that is capable of future use but is currently occupied by 2G and 3G (i.e. 900MHz, 2100MHz and much of the 1800MHz band). Use of this spectrum for 4G can only occur after the partial or complete transfer of customers to devices that do not rely on 2G or 3G service. [redacted].
- (d) Spectrum that may become available in future auctions that is capable of future 4G use (i.e. 2.3GHz, 3.4GHz and 700MHz<sup>96</sup>)

This is not correct from a timing viewpoint except in the very long term. The CMA's analysis should not be limited to effects on competition only in the very long term – effects over the short and medium terms are important. Furthermore, both Tables 1 and 2 (and presumably also redacted Figure 3) use historic 4G traffic levels. Given the forecast of rapid data growth, this is of no relevance to future traffic levels and future traffic levels per MHz.

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<sup>95</sup> [redacted]

<sup>96</sup> [redacted]

4G ready spectrum, where BT/EE has [redacted]% of the total holding, can make a contribution to capacity expansion much faster than the other categories of spectrum. BT/EE is only at present using 80MHz of its total 4G ready spectrum holding of [redacted]. By contrast, the other operators are already using all of their 4G ready spectrum<sup>97</sup> and have no more to presently add to further increase capacity.

- (iii) The CMA has considered the opportunity that operators have to increase their spectrum holdings from future auctions, and the possibility that this could reduce the current spectrum asymmetry.<sup>98</sup> However, Vodafone has several reservations with the CMA's analysis, which effectively treats the future auction spectrum as being equal in utility to all other spectrum currently licensed to mobile operators:
- (a) The CMA cannot rely upon the unknown future auction outcome, which may not necessarily reduce the current spectrum asymmetry. It is uncertain who will win the spectrum in future auctions and it could be BT/EE (in which case the spectrum asymmetry would be widened, not narrowed).
- (b) [redacted]
- (i) [redacted].<sup>99</sup>
- (ii) [redacted].<sup>100</sup>
- (c) Unlike spectrum already in the hands of operators (where the investment is effectively sunk), additional spectrum will have an incremental cost to acquire that will increase the cost of bringing it into service, over and above that of, for example, 4G ready spectrum.
- (iv) As Vodafone has explained, other methods of adding traffic capacity are more expensive and less effective, both in terms of the cost of achieving an

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<sup>97</sup> We understand that 3 is already using its last 2 x 5MHz of 1800MHz that it received from EE on 1 October 2015 and is currently bringing its 2\*5MHz of 800MHz into service.

<sup>98</sup> PF Report, Appendix G, paragraph 63 *et seq.*

<sup>99</sup> By way of comparison, the proposed reserve price for the 1800MHz band was 37 times greater (at £7.5 million per MHz) than the current reserve price for 3400MHz in the upcoming auction.

<sup>100</sup> Vodafone notes that the reserve price for the 2300MHz band is £1 million per MHz, which is similar to the actual price of unpaired 2600MHz achieved in the 2013 auction [redacted].

equivalent capacity increase and the elapsed time that will be necessary before any contribution to capacity increase can be made.<sup>101</sup> The CMA has not properly assessed the relative disadvantage of alternative methods of increasing capacity over deploying readily available additional spectrum.

In any event BT/EE will be equally (if not better) placed to use such putative alternative methods, such as re-farming or small cells, so that BT/EE could match at will other operators' capacity increases, and thereby [redacted] it will be able to hoard rather than deploy. EE has the most spectrum available to re-farm<sup>102</sup> and solutions such as small cells rely on access to an appropriate backhaul product at small cell locations, which are controlled by BT and, as discussed in Section 2(E), BT/EE would have the ability and increased incentive to frustrate or delay the development of infrastructure for small cells. Therefore, such methods should not be presented as an effective way for the other operators to match BT/EE's spectrum advantage and thereby force BT/EE to deploy (rather than hoard) its capacity advantage.

- (v) As a consequence, capacity constraints are a much more significant problem in the future for all operators than they will be for BT/EE. The CMA has therefore overestimated the ability of other operators to [redacted] force BT/EE to deploy all of its available capacity (rather than hoard it). This issue can be addressed by a divestment of BT's spectrum holding, particularly its paired 2600MHz holding.

4.4 Vodafone therefore considers that the loss of an independent BT with (i) strong incentives to deploy and use its spectrum to compete with other MNOs and MVNOs, and (ii) the potential to offer mobile packages in bundles with BT's market leading suite of fixed services, will mean that consumers will suffer a loss of competition in the form of the benefits of that spectrum being deployed. BT's spectrum will instead remain unused and retail competition will be less intense as a result, unless there is a spectrum divestment remedy.

4.5 Furthermore, Vodafone notes that the PFs are based in part on the finding that BT's femtocell strategy could be replicated to an extent by other MVNOs.<sup>103</sup> However, it is

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<sup>101</sup> See e.g. Initial Phase 2 Submission, paragraph 3.21; and Response to CMA Phase 1 questionnaire dated 2 April, questions 30 to 32.

<sup>102</sup> Table 5 fails to show the important fact that, although the holdings of spectrum available for re-farming are roughly similar between the existing operators, (with the exception of 3's holdings), EE in fact has the most spectrum available to re-farm. [redacted] Table 5 also fails to consider that BT's 2 x 15MHz of 2600MHz paired do not need to wait for re-farming to become useful for 4G. As such, re-farming is not an opportunity for operators to catch up with the size of BT/EE's 4G spectrum holding, but instead at best (in the absence of hoarding) a zero sum game.

<sup>103</sup> PF Report, paragraph 11.81(c).

unclear how the CMA reached this conclusion, in particular given that BT is the only MVNO with spectrum, which is crucial for such a strategy<sup>104</sup>, and that BT also has a unique network of street furniture (cabinets and poles) that could be used to complement femtocells in customer premises equipment with a network of outdoor small cells, as well as being the dominant fixed network in a converging market.

## 5. WHOLESALE BROADBAND

5.1 Vodafone disagrees with the PFs on BT's ability to foreclose SFBB inputs. In particular, the merger would result in BT having the enhanced ability and incentive to foreclose SFBB inputs by increasing the price of VULA (or reducing its retail SFBB price while leaving the wholesale price unchanged), either or both of which would foreclose competing SFBB providers.

### (A) Incorrect reliance on VULA margin test when this is highly uncertain due to existence of ongoing appeals

5.2 The CMA has acknowledged that there may be a merger-specific effect if regulation is not fully effective, i.e. BT may not be fully exploiting its ability to harm its rivals and the merger substantially increased BT's incentive.<sup>105</sup> The CMA provisionally considers that:

- (i) In the absence of *ex ante* regulation, BT would already have the ability to favour its own downstream business over rivals in the retail broadband market<sup>106</sup>;
- (ii) BT already has an incentive to foreclose other retail broadband suppliers even absent the merger, and the merger may increase BT's incentives to foreclose rivals<sup>107</sup>; and
- (iii) At least some (if not all) forms of foreclosure are likely to have an effect on downstream competition.<sup>108</sup>

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<sup>104</sup> In its Phase 2 Submission, Ofcom also notes that BT "is the only holder of mobile spectrum in one of the main bands currently being used for 4G services (2.6 GHz) that is not currently a national MNO" and that this is "the attribute that makes BT stand out as a potential competitor in the retail market, and distinguishes it from other MVNOs and potential operators" (paragraphs 1.13 and 3.19).

<sup>105</sup> PF Report paragraph 18.31.

<sup>106</sup> PF Report paragraph 18.50.

<sup>107</sup> PF Report paragraphs 18.32 to 18.34.

<sup>108</sup> PF Report paragraph 18.36.

- 5.3 The CMA has therefore assessed whether the VULA margin test is effective and whether the merger will reduce its effectiveness. The CMA provisionally finds it unlikely that the VULA margin test is currently ineffective in preventing BT from foreclosing its rival CPs to a material extent based on Ofcom's submissions.<sup>109</sup>
- 5.4 Vodafone does not agree with this PF as it does not take into account the fact that reliance on the VULA margin test is highly uncertain, first, by its very nature, which depends on uncertain implementation by Ofcom of already highly detailed and complex guidance that allows multiple points of disagreement, and second because the test and guidance is under appeal. While the CMA has noted the existence of the appeals, it has not considered the impact of the appeals on the effectiveness of the regulatory constraints on BT's ability to foreclose rival CPs. If BT's appeal is successful, it is possible that the VULA margin test will not exist post-merger, so would not prevent BT's ability to foreclose rival CPs. This is another example of BT's aggressive approach to combating the effect of regulation. The merger will increase BT's ability and incentives to foreclose rivals (such that there is a merger-specific effect), and such foreclosure may be expected to result in a SLC in the retail broadband market.

**(B) Amending guidance or departing from guidance should be considered future regulation**

- 5.5 The CMA has acknowledged that the merger may lead to an increased ability to foreclose if the VULA margin test is effective now but the merger will reduce its effectiveness.<sup>110</sup> The CMA also considered it likely that Ofcom will have to adapt its implementation of the VULA margin test to deal with different issues as a result of the merger.<sup>111</sup> However, the CMA then concludes that Ofcom departing from its guidance or amending its guidance should be viewed as part of the existing VULA regulatory framework rather than new regulation.<sup>112</sup> The CMA therefore provisionally concluded that Ofcom can be expected to take the steps needed to address a future reduction in the effectiveness of the VULA margin test caused by the merger, and that it is not likely that any such reduction will require material amendments to the regulation of VULA.<sup>113</sup>
- 5.6 Vodafone does not agree with this PF and considers this to be a serious error of law. Changes to or departures from the prevailing guidance should be regarded as future

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<sup>109</sup> PF Report paragraphs 18.51 and 18.77.

<sup>110</sup> PF Report paragraph 18.50.

<sup>111</sup> PF Report paragraph 18.68 and 18.77.

<sup>112</sup> PF Report paragraph 18.72.

<sup>113</sup> PF Report paragraph 18.78.

regulation because it is not currently in effect and Ofcom is under no obligation to change or depart from the prevailing guidance. There is significant uncertainty as to whether the VULA margin test guidance will be amended to address the issues with its effectiveness resulting from the merger, how it will be amended, when it will be amended and whether the amendments will be effective. Any such amended guidance would also be subject to consultation. The CMA therefore cannot rely on Ofcom changing its guidance or departing from its guidance to address the issue that the merger will reduce the effectiveness of the VULA margin test. This is particularly the case given the VULA margin test itself is still under appeal.

- 5.7 The CMA has stated that where a change would involve, in effect, new regulation in the future, the CMA would “*consider first whether that future regulation is more likely than not to come into force (and that no SLC arises between completion of the merger and such future regulation coming into force) and secondly whether such regulation would be effective*”.<sup>114</sup> In circumstances where Ofcom has provided no assurance as to whether, how and when it would change or depart from the guidance on the VULA margin test, it is pure speculation to conclude that changes to or departures from the guidance would be, under the CMA’s self-stated test, “*more likely than not to come into force*” and the CMA has no basis on which to assess how effective any such guidance would be.
- 5.8 There is also no certainty as to when Ofcom will amend or depart from the guidance on the VULA margin test so as to deal with the different issues resulting from the merger. In the absence of any assurance from Ofcom that this will be in effect from completion, there would likely be a significant time lag between completion of the merger and any such new guidance coming into force, particularly if the likely appeals by BT of such new guidance involve interim suspension of its application. The CMA has not analysed whether a SLC arises in this period. Vodafone is concerned that it is more likely than not there will be an SLC in the retail broadband market in this period, if not for a longer period of time.
- 5.9 For the reasons outlined above, changes to or departures from the prevailing guidance on the VULA margin test are not sufficiently definitive to be included in the counterfactual or the competitive assessment. The merger will reduce the effectiveness of the VULA margin test and will therefore increase BT’s ability to foreclose, which would result in an SLC in the retail broadband market. The CMA has a duty under section 41 of the Enterprise Act 2002 to take such action as it considers to be reasonable and practicable to remedy, mitigate or prevent the SLC and any adverse effects which have resulted from, or may be expected to result from, the SLC. The CMA

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<sup>114</sup> PF Report paragraph 18.74.

cannot rely on uncertain potential changes to or departures from prevailing guidance to fulfil this duty.

## 6. WHOLESALE MOBILE

6.1 For the reasons outlined in Vodafone's previous submissions, provided the backhaul, network sharing and spectrum issues are addressed, Vodafone considers the proposed merger will not create or enhance BT/EE's ability to engage in a strategy of total or partial foreclosure against fixed-MVNOs. In this situation:

- (i) If the merged entity engages in total or partial foreclosure strategies against fixed-MVNOs, those MVNOs would remain able to gain wholesale contracts from Vodafone, O2 and 3 (or a merged 3/O2). As explained previously, Vodafone is committed to remaining a key competitor in supplying wholesale mobile services to MVNOs. In relation to 4G, [redacted] and remains prepared to do so on the basis of wholesale pricing that appropriately shares the cost of Vodafone's incremental 4G investment.<sup>115</sup> Vodafone strongly refutes any claims that it has withdrawn from the market and/or is attempting to engineer the withdrawal of others.

Vodafone also strongly refutes TalkTalk's allegation that Vodafone desires to engineer a tacit agreement amongst MNOs to withdraw service from any MVNOs.<sup>116</sup> TalkTalk has not provided any evidence to support this baseless allegation. Post-merger, if the issues discussed above are addressed, even if EE were to refuse to bid, Vodafone would be incentivised to bid for fixed-MVNO contracts because it would compete against O2 and 3 (or a merged 3/O2) for such contracts.

Vodafone also does not agree with TalkTalk's allegation that Vodafone's incentives to offer wholesale access to MVNOs are in any way clouded by its move into fixed-line products.<sup>117</sup> Vodafone only entered the fixed broadband market in June 2015 [redacted]. Therefore, if fixed-mobile bundles grew in prevalence, Vodafone would have strong incentives to bid strongly for fixed-MVNO contracts (in addition to an incentive to grow its own fixed-mobile offer organically).

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<sup>115</sup> See, for example, Vodafone's response to questions 33 and 35 of the Phase 2 Questionnaire.

<sup>116</sup> PF Report paragraph 14.67.

<sup>117</sup> PF Report paragraph 14.67.

Vodafone agrees with the CMA that, if fixed-mobile bundles grew in prevalence, and provided the issues discussed above are addressed, 3 and O2 (or the merged 3/O2) would also have even stronger incentives to bid aggressively to supply wholesale mobile services to a fixed-MVNO that can attract retail customers that they cannot as they do not have significant fixed offerings.

- (ii) Vodafone agrees that the nature of the tender process for wholesale mobile services will enable fixed-MVNOs to obtain competitive terms with the participation of only two MNOs, provided that these MNOs both are not constrained in terms of spectrum capacity or networks. This is because there is no transparency in the tender process for wholesale mobile services so it is impossible to know which MNOs are bidding and which MNOs are not bidding in a tender. The CMA has already noted its understanding that “*pre-merger some MVNOs did in fact use the perceived presence of another MNO [in negotiations]*”.<sup>118</sup> [redacted] Even if there are only one or two bidders, the MNOs do not know this fact. In any event, the belief that there is one other serious bidder is sufficient to ensure that competitive terms are offered. Therefore, even if BT/EE does not bid, this would not cause the other MNOs to change their bidding strategy and all other MNOs would continue to compete strongly for the fixed-MVNO contract.

This also makes it difficult for BT/EE to credibly commit not to bid to supply wholesale mobile services to particular fixed-MVNOs.

- (iii) [redacted].<sup>119</sup> [redacted].
- (iv) Vodafone agrees with paragraph 14.119 of the PF Report. The customer bases of Sky and TalkTalk will likely be significant at the expiry of the long term agreements they have signed with O2, such that any cannibalisation of retail customers would already have taken place. Therefore, Sky and TalkTalk will be very attractive to MNOs at contract renewal as winning such MVNO contracts would provide, on a net basis, new margin and revenues.
- (v) Vodafone agrees with the statement in paragraph 14.105 of the PF Report that a fixed-MVNO may have increased countervailing buyer power if the MNO requires wholesale access to an input offered by the fixed-MVNO (such as mobile backhaul in the case of Virgin Media or TV content in the case of Sky). This could assist such fixed-MVNOs in their negotiations and increase their

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<sup>118</sup> PF Report paragraph 14.29.

<sup>119</sup> See Vodafone's response to question 35 of the Phase 2 Questionnaire.

bargaining power with MNOs – concentration levels are significantly higher in both fixed access and premium TV content compared to mobile.

- (vi) Therefore, even if the merged entity attempted to engage in total or partial foreclosure strategies against fixed-MVNOs, those MVNOs would not face higher wholesale prices (and/or lower quality) for their wholesale mobile inputs because Vodafone, O2 and 3 (or a merged 3/O2) would continue to bid strongly for the fixed-MVNO contracts and would not risk degrading their wholesale offers given the strength of competition for such contracts and the opaqueness of the tender process.
- 6.2 In these circumstances, BT/EE would not have the ability to cause a price rise or quality degradation by attempting to engage in a total or partial foreclosure strategy, so it would also have no incentive to engage in such strategies.<sup>120</sup>
  - 6.3 Provided the backhaul, network sharing and spectrum issues are addressed, Vodafone therefore supports the CMA's PF that the merger is not expected to result in an SLC in any market(s) in the UK as a result of a foreclosure strategy by BT/EE in the wholesale mobile market.
  - 6.4 Vodafone notes that the CMA panel was divided in relation to this concern. Vodafone notes that if the CMA were to change its finding on wholesale mobile, the CMA would need to allow third parties, including Vodafone, sufficient time to review and comment on any potential remedies. Any remedy that specifies the terms and conditions on which BT/EE must provide wholesale mobile inputs to fixed-MVNOs would likely have a significant distortive impact on competition in the wholesale mobile market and therefore should not be undertaken lightly.

## **7. INTERRELATED EFFECTS**

- 7.1 Vodafone continues to have concerns in relation to mobile backhaul input foreclosure, retail mobile and wholesale broadband (as set out in this and previous submissions, and as summarised in paragraph 1.2 above) and considers that each of these issues represents a SLC in its own right.
- 7.2 The PFs have found otherwise. However, Vodafone considers that the PFs have not sufficiently considered the interrelated effects of the individual theories of harm and whether the overall effect of the merger would give result in an SLC 'in the round', especially in telecommunications markets which are converging. The concerns

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<sup>120</sup> Vodafone agrees with the statement in paragraph 14.136 of the PF Report that "*if the merged entity did not have the ability to cause a price rise at this level by not bidding, it would not have the incentive to withdraw.*"

Vodafone have identified cumulatively result in an SLC 'in the round', particularly given BT/EE's competitors in both broadband and mobile services will continue to depend on BT/EE for key inputs required to provide such services (where BT is the incumbent), and the merger will result in BT/EE having an enhanced ability and/or incentive to foreclose access to the key inputs of mobile backhaul and wholesale broadband.

- 7.3 It is not clear where the CMA has considered whether the theories of harm could interlink or amplify each other. Rather, the CMA has simply addressed interrelated concerns on the basis that they have found elsewhere that there is no ability or incentive for the merged entity to foreclose its competitors for an individual input. Many of these findings are based on areas where there is uncertainty or limited evidence so there remains a significant risk that the overall effect of the merger would result in an SLC.

## Annexure 1: Paragraph level clarifications in PFs

### 1. Wholesale mobile

- 1.1 The CMA refers to “*Sainsbury’s Mobile*” at **paragraph 13.34** and describes it as having “*previously had a joint venture with Vodafone, although it is now wholly owned by Sainsbury’s*”. This is factually incorrect: Mobile by Sainsbury’s continues to be owned as a 50/50 joint venture between Sainsbury’s and Vodafone, [redacted]. As previously explained<sup>121</sup>, the joint venture will cease to provide mobile services in January 2016 [redacted].
- 1.2 At **paragraph 13.35**, the CMA describes a full or thick MVNO as having “*more control over the services it can offer (for example what tariffs it can provide)*”. This is not in fact a difference between light/thin MVNOs and full/thick MVNOs: all MVNOs can decide what tariffs they provide. The difference is the level of control that the MVNO has over the process: full or thick MVNOs tend to have more control, which may make it easier or faster to change tariffs, or enable the MVNO to offer more complex or innovative tariffs.
- 1.3 At **paragraph 14.28**, the CMA notes that “*Vodafone Group’s CEO suggested that in certain circumstances, supplying 4G services to MVNOs may be uneconomic, [redacted]. Vodafone submitted to the CMA that it remains determined to do so*” and footnoted that the CEO’s statements “*suggested that engagement in the MVNO market may not be worth it and, in relation to 4G, MVNOs would be expected to pay their fair share*”. This is noted in the context where the CMA considered that the merged entity may have reasons to underplay its presence in the market whilst nevertheless entering into negotiations with some MVNOs, as this could result in a better deal than it would have achieved if it had been visibly competing. Vodafone has the following issues with this paragraph:
- (i) The CMA’s description gives a misleading impression of the statements made by Vodafone Group’s CEO, in particular failing to refer to other comments made in the same Interim Management Statement which confirmed that Vodafone was “*determined not to stop working with MVNOs*” and plans to continue working “*with MVNOs that are willing to recognise the value and the cost of spectrum, particularly 4G*”.<sup>122</sup>
  - (ii) This paragraph gives the misleading impression that Vodafone may be underplaying its presence in the market while nevertheless entering into

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<sup>121</sup> Response to the CMA’s question of 19 October 2015.

<sup>122</sup> Vodafone (6 February 2014), Interim Management Statement, page 11. Vodafone has also previously made this clarification in its comments to the CMA’s putback on 27 October 2015.

negotiations with some MVNOs, on the basis that this could result in a better deal than it would have achieved if it had been visibly competing. Vodafone strongly refutes that this is what it is doing. Vodafone has not underplayed its presence in the market. The statement the CMA has quoted in fact makes it clear that Vodafone is determined not to stop working with MVNOs.

## 2. Mobile backhaul

2.1 At **paragraph 15.22**, the CMA notes that Virgin Media “operates only within its network footprint, but could in principle extend its presence by using Openreach’s regulated inputs”. While Vodafone acknowledges that extending Virgin Media’s network is a theoretical possibility, there are significant practical difficulties involved in doing so which the CMA does not appear to take into account:

- (i) It is unclear whether Virgin Media is in any, let alone all of the BT ASNs such that it is able to economically use Openreach inputs to extend its network – if it is not, it would take some time for Virgin Media to roll out to all the ASNs in order to be able to extend its presence in the way that the PFs suggest; and
- (ii) In any event, Virgin Media is unlikely to have the incentive to incur these costs and risks of expanding its network where the vast majority of backhaul demand is non-contestable due to the MNOs’ long term and high volume commitment contracts with BT Wholesale<sup>123</sup> and assuming the continuing absence of access to BT’s dark fibre on economic terms.

Virgin Media previously sold its broadband base that was serviced over BT’s network because it was uneconomic, indicating that there is no synergy with the broadband roll out and suggesting that this would also apply to any attempt by Virgin Media to supply backhaul over the BT network.

2.2 At **paragraphs 15.33 and 16.94** (and similarly in **Appendix K, paragraphs 33, 34 and 136**), the CMA notes that [redacted].<sup>124</sup>

2.3 The CMA has noted the economic benefits of dark fibre for MNOs at **paragraph 15.34 to 15.35**, commenting that “*The main attraction of dark fibre to MNOs is that costs do not increase with the volume of data carried*”. While Vodafone agrees with the CMA’s observations in this section, Vodafone notes that the CMA has not taken into account any of the other (in particular, quality) benefits of dark fibre. For example, as previously

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<sup>123</sup> [redacted]

<sup>124</sup> TOH 4 Letter, paragraph 2.12(iv).

submitted to the CMA, dark fibre would enable CPs to have greater control over the quality of any managed backhaul service they provide using dark fibre inputs, as they would be responsible for installing and repairing the active equipment (as recognised by Ofcom itself).<sup>125</sup> [redacted]<sup>126</sup>

- 2.4 At **paragraph 16.92**, the CMA “*considered that BT Wholesale would be aware of or have a good indication as to what the cost of an MNO’s next best alternative would be and so would be pricing its MEAS service at or slightly below that cost*”. However, there is no indication of how BT would be aware of the cost of self-supply and/or the prices of alternative suppliers in a market where prices are not public (unless shared by the MNO with BT), and in particular where it is not clear whether a “*next best alternative*” even exists for certain MNOs. Furthermore, the CMA itself notes that there is “*limited data on pricing*”<sup>127</sup>; as such, Vodafone is unclear as to the CMA’s basis for its assumption that BT Wholesale would be able to price so as to match or marginally beat the “next best alternative” to its MEAS service.
- 2.5 At **paragraph 16.116**, the CMA notes that “*Vodafone told us that it would be able to provide an IP/VPN service using its platform capabilities*”. [redacted]<sup>128</sup>
- 2.6 In the **footnote to paragraph 16.147**, the CMA notes that, [redacted]<sup>129</sup>
- 2.7 In **Appendix K**, the CMA notes at **paragraph 7** that “*Openreach’s decision on the implementation of a product request is based on considerations of its commercial and technical viability, where commercial returns are assessed only in relation to Openreach, without consideration of the impact on the rest of BT Group*” and cites the EAB Annual Report 2014 as support for this statement. However:
- (i) Page 16 of the EAB Annual Report 2014, as cited by the CMA, states only that “*Openreach prioritises SoRs on the basis of potential commercial return and that, as a result, some SoRs will not necessarily be taken forward*”. There is no explicit mention that the “*commercial return*” must be assessed only in relation to Openreach and exclude the wider BT Group. Furthermore, in the 2015 Annual

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<sup>125</sup> See further Ofcom Letter, paragraph 2.6(ii).

<sup>126</sup> Response to Phase 2 questionnaire dated 24 June 2015, question 47.

<sup>127</sup> Appendix K, paragraph 141.

<sup>128</sup> Response to CMA questions of 18 August 2015, question 18.

<sup>129</sup> Response to CMA questions of 28 September, Table 1.1. [redacted]

Report, the EAB noted that the transparency of this process “*remains a cause of industry concern*”.<sup>130</sup>

(ii) The BT Undertakings themselves do not exclude the possibility that Openreach may take into account the wider BT Group when making its assessment of SoR requests, specifying only that, “*AS [i.e. Openreach] is free to treat those requests as would any other commercial organisation and to accept or reject them on the basis of, among other things:*

(a) *fit with the assets, skills and resources and terms of reference of AS;*

(b) *commercial attractiveness to AS; and*

(c) *opportunity cost to AS*”.<sup>131</sup>

Although the BT Undertakings note that, “*Where the Downstream Divisions [of BT] require changes or enhancements*” to certain products, this must operate “*without undue discrimination*”, the obligation to ensure such a process lies with “*BTWS*” and “*BTS*” (both divisions within BT Wholesale) and not Openreach (which is referred to in the BT Undertakings as “*AS*”).<sup>132</sup>

There is therefore very little support (in both the BT Undertakings themselves and in EAB Annual Report 2014) for the CMA’s statement that the interests of the BT Group are in fact excluded from Openreach’s treatment of SoR requests.

2.8 In **Appendix K**, the CMA states at **paragraph 54** that “*Although the regulated prices of Openreach’s products do constrain the price of managed backhaul somewhat, the constraint does not appear to be binding at current prices:* [redacted] in particular since elsewhere the CMA notes that BT has an incentive to charge Vodafone high [redacted].<sup>133</sup>

2.9 In **Appendix K**, the CMA notes at **paragraph 151** that [redacted]<sup>134</sup> [redacted].

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<sup>130</sup> EAB Annual Report 2015, page 17.

<sup>131</sup> BT Undertakings, paragraph 5.11.

<sup>132</sup> BT Undertakings, paragraph 8.7.

<sup>133</sup> For example, at paragraph 16.97 and Appendix K, paragraph 138 the CMA “*considered that BT would have an incentive to charge a high price at these sites even pre-merger*”.

<sup>134</sup> Response to CMA putback by email dated 19 October 2015.

2.10 With respect to the CMA's comment in **Appendix K, paragraph 195** [redacted].<sup>135</sup> [redacted]<sup>136</sup>. [redacted].<sup>137</sup>

### **3. Wholesale broadband**

3.1 The CMA has noted in at **paragraphs 20.69 and 20.73 and in Appendix L, paragraph 58** that "*Vodafone said that it does not currently plan to provide fixed retail broadband services in Market A*". However, as previously submitted<sup>138</sup> and as acknowledged elsewhere in the CMA's PFs<sup>139</sup>, [redacted]. Vodafone suggests that paragraphs 20.69, 20.73 and Appendix L, paragraph 58 are similarly amended to reflect this clarification.

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<sup>135</sup> See for example Initial Phase 2 Submission, paragraph 2.34.

<sup>136</sup> Hearing Transcript, page 46 (lines 6 to 14) and Letter dated 23 September 2015.

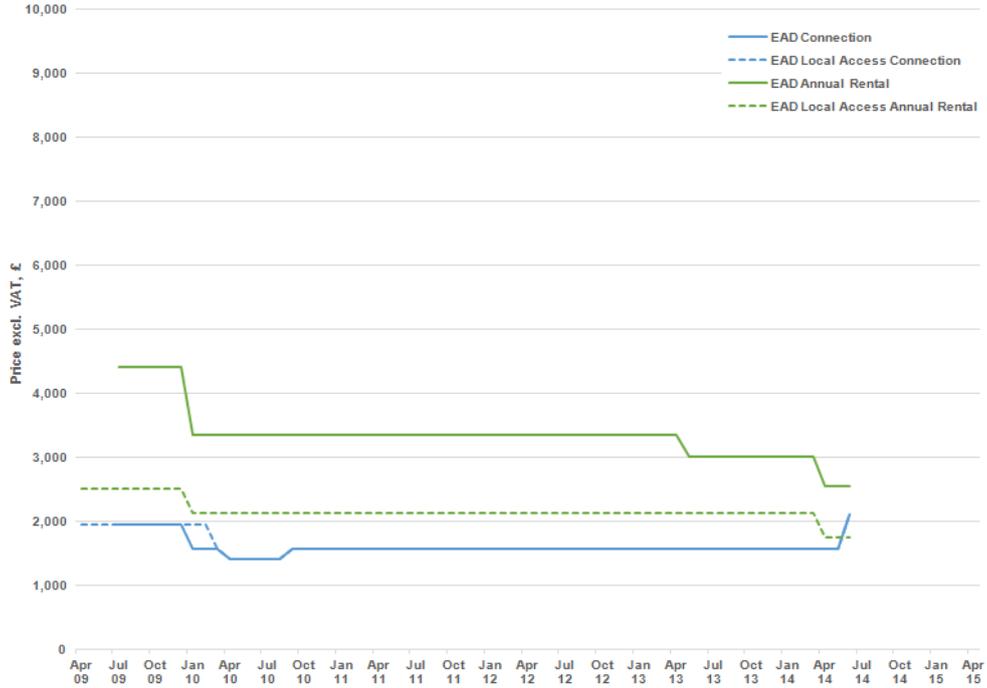
<sup>137</sup> [redacted].

<sup>138</sup> Response to CMA putback on 27 October 2015.

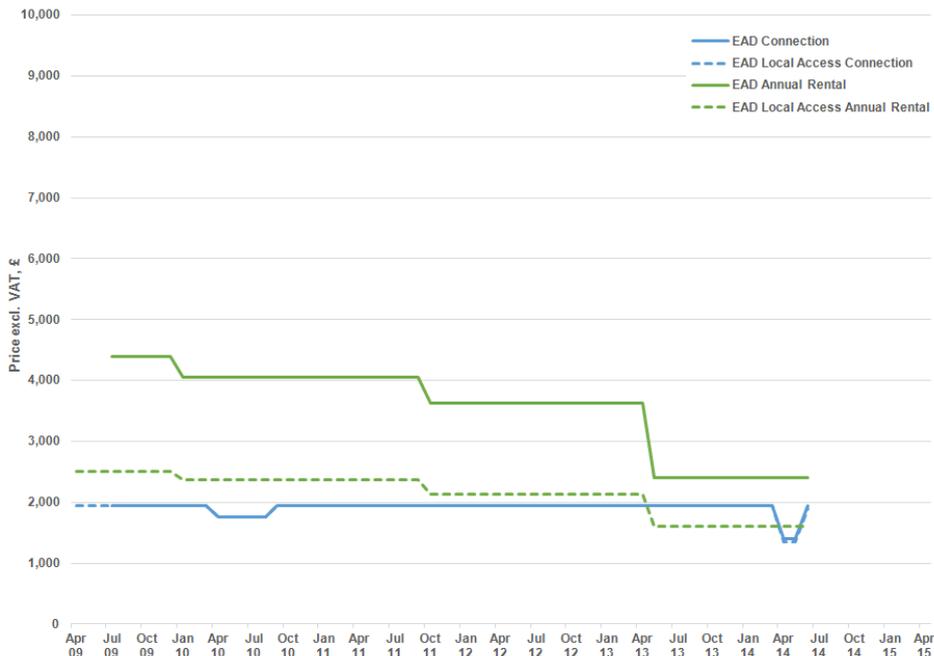
<sup>139</sup> PF Report, paragraph 20.77 (confidential version).

Annexure 2: Analysis of historic BT Openreach prices

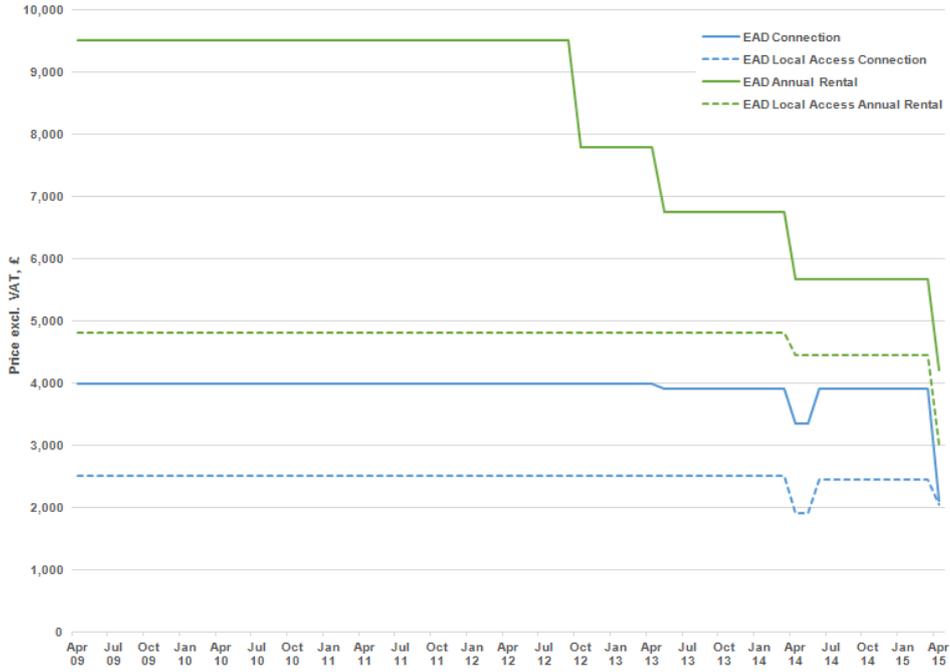
**Figure 2.1**  
**Comparison of historic pricing for EAD 10 and EAD Local Access 10**



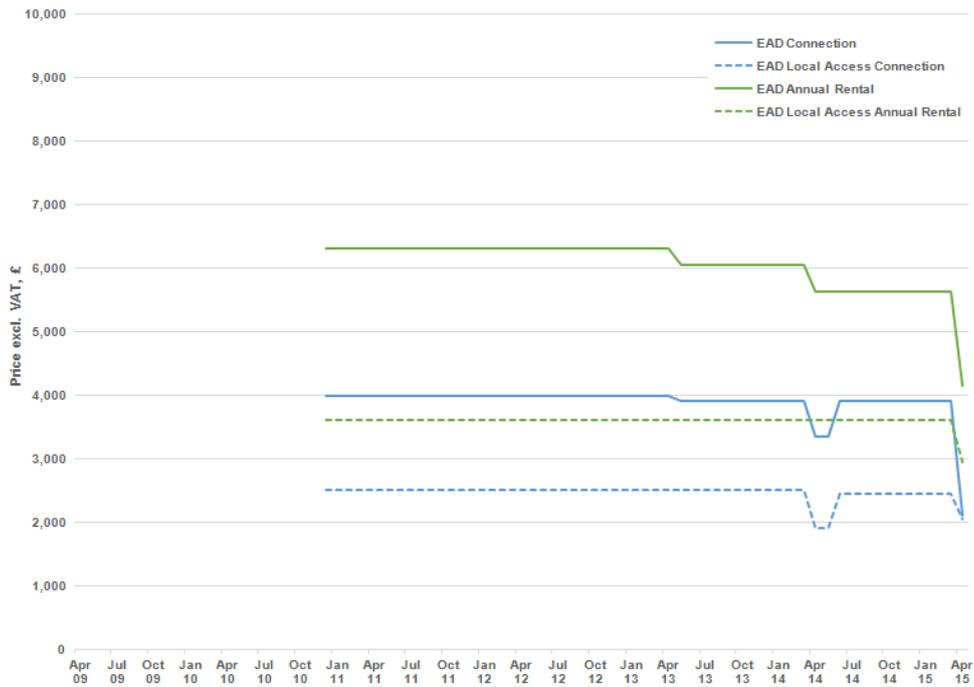
**Figure 2.2**  
**Comparison of historic pricing for EAD 100 and EAD Local Access 100**



**Figure 2.3**  
**Comparison of historic pricing for EAD 1000 and EAD Local Access 1000**



**Figure 2.4**  
**Comparison of historic pricing for EAD 1000 and EAD Local Access 1000 (60 month minimum period)**



**Figure 2.5**  
**Comparison of historic pricing for EAD 1000 and EAD Local Access 1000 (84 month minimum period)**

