



**SKY'S RESPONSE TO THE CMA'S PROVISIONAL FINDINGS REPORT
IN THE PHASE II REVIEW OF BT'S ANTICIPATED ACQUISITION OF EE**

This is Sky's response to the CMA's provisional findings report (the "Provisional Findings") published on 30 October 2015 in the Phase II inquiry into BT's anticipated acquisition of EE (the "Merger"). This response supplements and should be read in conjunction with Sky's previous submissions.

1. Executive summary

- 1.1 Sky disagrees with the conclusions set out in the Provisional Findings, which, contrary to the considerable body of evidence submitted by Sky¹ and multiple other third parties indicating that the Merger is likely to give rise to a substantial lessening of competition ("SLC"), conclude that no SLC arises in any of the areas under consideration.
- 1.2 The Provisional Findings consistently underplay probative evidence provided by wholesale customers and express an undue reluctance to rely on forward-looking evidence. In a number of cases, where the CMA is faced with a broad range of evidence expressing different views, it finds in favour of the merging parties. This ultimately leads it to conclude that the Merger does not give rise to SLCs.
- 1.3 This approach infects, in particular, the assessment in the Provisional Findings of foreclosure risks in wholesale mobile services and inputs related to small cell deployment.
- 1.4 In relation to wholesale mobile services, there is sufficient and reliable evidence to conclude that the Merger is likely to give rise to a SLC. Sky notes that the CMA is in the unusual situation at provisional findings stage of having dissenting Members of the Inquiry Group, who appear to share the view of Sky and others to this effect.
- 1.5 The provisional finding of no SLC in wholesale mobile services has been based on:
 - 1.5.1 use of an incorrect counterfactual;
 - 1.5.2 fundamental flaws in the economic analysis performed resulting in (i) a failure to properly assess the risk of partial foreclosure of fixed MVNOs under future contracts with the merged entity; and (ii) an erroneous finding that total and partial foreclosure risks do not arise;
 - 1.5.3 insufficient weight being placed on evidence from Sky and others as to the nature of the MVNO tender process and the limited ability of fixed MVNOs and alternative MNO hosts to counter foreclosure strategies employed by the merged entity; and
 - 1.5.4 insufficient weight being placed on the evidence of negative effects on wholesale customers and in turn the likelihood of negative retail effects being unduly dismissed.

¹ Sky does not seek in this response to repeat the extensive evidence previously submitted or the detailed submissions made to date in the merger review process. Sky does, however, continue to stand by its previous submissions and this response should be read in conjunction with those.

- 1.6 A failure to fully appreciate these foreclosure risks has serious consequences for competition and consumers if left unchecked. Sky urges the CMA to revisit the economic analysis given the flaws identified below and to reconsider the totality of the evidence and submissions it has received. Sky also outlines a potential remedy to the SLC in wholesale mobile services which would be a proportionate way to alleviate these concerns.
- 1.7 In relation to small cells, the Provisional Findings fail to recognise the importance of small cells to retail competition in the short to medium term. That leads to a somewhat incoherent analysis of foreclosure in relation to small cell deployment. Access to backhaul and sites for small cells is addressed to some degree in the assessment of mobile backhaul input foreclosure, but there are material flaws in this assessment. Access to spectrum is addressed in the consideration of dynamic retail mobile competition, but not in relation to small cells, and there are also material flaws in this assessment. Ultimately, this leads to the unfounded conclusion that small cell deployment by the merged entity would be fully replicable by competitors. As Sky sets out in this response, if the CMA were to revisit the analysis of foreclosure in relation to small cell deployments in a more holistic way across backhaul, sites and spectrum, correcting the flaws in the analysis, it would find a SLC in the retail mobile market that would require remedial action prior to clearance of the Merger.
- 1.8 Finally, Sky addresses the treatment of existing regulation of BT's wholesale superfast broadband services. The Provisional Findings note that the Merger has effects which require adaptation of existing regulation. In these circumstances, it is important for the CMA, as part of its review of the Merger, to set out its view on the specific adaptations and guidance required, including relevant timeframes for implementation. It is neither sufficient nor appropriate for the CMA to delegate responsibility for this to Ofcom to action in an unspecified way and at an undefined point in the future.
- 1.9 The Merger brings together the UK's incumbent fixed broadband provider with the UK's largest mobile operator and has the potential to have far-reaching damaging effects across the UK communications sector. Absent remedial action, SLCs are likely to arise in wholesale mobile services and in respect of small cell deployments, ultimately leading to a significant loss of competition, including the stifling of emerging competition and technologies in retail mobile. Adverse effects from the Merger in relation to retail superfast broadband competition will also go unchecked unless and until Ofcom takes action, allowing BT to strengthen further its already strong position and adding to the risk of re-monopolisation in fixed broadband services. Together, these adverse effects would have far-reaching consequences for wholesale customers and consumers in the UK communications sector, upon which so many parts of the UK's economy depend.
- 1.10 Before proceeding to its final report, the CMA should therefore revisit its analysis as indicated, in order to draw reliable conclusions as to whether SLCs arise from the Merger, and consult on appropriate remedies where the likelihood of SLCs is confirmed.

2. Wholesale mobile services

- 2.1 Sky considers there is sufficient and reliable evidence of a SLC in the market for wholesale mobile services.² The evidence provided in Sky's previous submissions³ and the submissions of multiple third parties⁴ in the merger review thus far supports such a finding. The CMA should therefore identify a SLC and consult on remedial action before proceeding to clearance of the Merger.

² In this respect, Sky supports the conclusions of the dissenting Members of the CMA's Inquiry Group, set out at paragraphs 14.278 to 14.279.

³ See Sky's response to the CMA's Phase I Preliminary Invitation to Comment ("Sky Phase I Response") Section 5(B)(iv), Sky's response to the CMA's Phase II Request for Third Party Views ("Sky Phase II Response") Section 6 and Sky's response to the CMA's Statement of Issues ("Sky Statement of Issues Response") Section 4(A)(ii).

⁴ See for example TalkTalk, Telefonica and Vodafone's Phase II Hearing Summaries.

- 2.2 In this section, Sky explains the analytical and evidential basis for its view that a SLC is likely to arise as a result of both partial and total foreclosure in wholesale mobile services, as well as addressing the material flaws underpinning the Provisional Findings which presently conclude that there is no SLC. This section should be read together with the detailed economic assessment of the errors in the Provisional Findings' foreclosure analysis set out in the CRA paper provided at Annex 1. Sky also outlines a possible merger remedy to address the SLC at the end of this section.
- 2.3 In summary, there are strong grounds to conclude that a SLC is likely to arise in wholesale mobile services, on the basis of the following factors (a number of which are already identified by the dissenting Members):
- 2.3.1 Correct application of the counterfactual identifies an imminent reduction in the number of alternative MNO hosts, other than the merged entity.
- 2.3.2 Correction of the flaws in the overarching analytical approach of the Provisional Findings would enable meaningful conclusions to be drawn.
- 2.3.3 Detailed assessment of partial foreclosure risks is required before dismissing a finding of SLC. The dissenting Members note that the merged entity's incentives to foreclose would likely manifest themselves in restrictions in the range and quality of services offered and/or price increases.
- 2.3.4 Strong evidence to show that MVNOs will not have the ability to extract competitive wholesale terms post-merger and alternative MNOs cannot restore the wholesale competition lost. The dissenting Members identified that foreclosure by the merged entity would not be neutralised by alternative MNO hosts.
- 2.3.5 Broad industry consensus regarding the likely importance of fixed-mobile bundles post-merger. The dissenting Members considered it sufficiently likely that fixed-mobile bundles would become increasingly prevalent, such that the merged entity would have the incentive to foreclose fixed MVNOs.
- 2.3.6 Both partial and total foreclosure strategies would give rise to clear effects in wholesale and downstream retail markets. The dissenting Members noted that foreclosure would likely give rise to higher prices and/or reduced quality in MVNO contracts and this was sufficient to establish a SLC in the wholesale market. In addition, there were likely to be adverse effects downstream.
- 2.4 Further, the analysis and conclusions of the dissenting Members (and the reasons of the rest of the Inquiry Group for dismissing them) are an important aspect of the CMA's assessment and should be set out in full. The abbreviated outline of the dissenting Members' conclusions provided at paragraphs 14.278 - 14.279 is helpful but offers respondents insufficient insight into the underlying reasoning.

2(A) Appropriate application of the counterfactual

- 2.5 An important preliminary step is to identify the correct counterfactual against which to judge the effects of the Merger.
- 2.6 An appropriate application of the counterfactual would reflect three MNOs going forward, not the four assumed in the Provisional Findings.
- 2.7 In examining the Merger, the CMA must apply the most likely counterfactual.⁵ The CMA states that it has taken into account the proposed acquisition by Hutchison 3G of

⁵ Paragraph 4.3.6 Merger Assessment Guidelines, CCR2 (Revised), September 2010 (the "Merger Assessment Guidelines").

Telefonica UK⁶ (the “H3G/O2 Merger”) in its assessment.⁷ However, the application of the counterfactual in the Provisional Findings is erroneous.

- 2.8 In previous cases, the CMA has rightly assumed that parallel transactions are proceeding and therefore assessed the relevant transaction against a counterfactual where further consolidation has occurred.⁸ The CMA should take the same approach here. Instead, the Provisional Findings assesses the Merger against a counterfactual where four MNO hosts remain in the market.⁹
- 2.9 It is correct that the CMA should not speculate unduly as to the outcome of the H3G/O2 Merger. However, in assuming the continuing existence of four MNO hosts in the market, the Provisional Findings in effect speculate that either the merger is prohibited, or the condition of clearance is the creation of a new fourth MNO credibly able to host scale fixed MVNOs.
- 2.10 Prohibition is not the most likely outcome of the H3G/O2 Merger – indeed only four mergers have ever been prohibited under the current EU merger regulation.¹⁰ Nor is a condition requiring the creation of a new fourth MNO likely; this has not been a feature of previous clearance decisions in relation to horizontal mergers of MNOs.¹¹ It does not therefore follow that a merger involving the loss of an inactive potential MNO host - H3G - should lead to the creation of a new fourth MNO host, still less that it would host scale fixed MVNOs on competitive terms.
- 2.11 The most likely counterfactual is therefore that only three MNOs will remain in the market after the H3G/O2 merger.
- 2.12 In any event, for the reasons explained in the sections below and in the CRA paper, the proposed transaction would give rise to a SLC in mobile hosting even if four MNOs remained in the market post-merger.

2(B) The issues considered in the Provisional Findings

- 2.13 The Provisional Findings consider the following three permutations of its theory of harm in relation to wholesale mobile services:
- (a) total foreclosure through refusal to supply fixed MVNOs;
 - (b) partial foreclosure of Virgin Media in its existing contract; and
 - (c) partial foreclosure through supplying at higher wholesale prices and/or reduced quality for fixed MVNOs in future contracts.
- 2.14 This response focuses on the Provisional Findings in relation to (a) and (c) above. Permutation (b) is not discussed further, as it is a matter between Virgin Media and the merged entity, depending primarily on the construction of Virgin Media’s existing

⁶ This is currently being reviewed by the European Commission as Case M.7612.

⁷ See paragraph 4.17 of the Provisional Findings, referencing the CMA’s approach to the counterfactual set out in Chapter 7 of the Provisional Findings.

⁸ For example, in its consideration of the anticipated acquisition by Nasdaq Stock Market Inc of the London Stock Exchange plc in January 2007, the CMA (then the Office of Fair Trading, rightly took into account the parallel merger between NYSE and Euronext as part of its counterfactual. In that case, the OFT assessed the transaction as a 3 to 2 merger (see, for example, paragraph 26 of the OFT’s decision).

⁹ See, for example, paragraphs 14.41 to 14.100; 14.118; 14.121.

¹⁰ COMP/M.4439 Ryanair/Aer Lingus; COMP/M.5830 Olympic Air/Aegean Airlines; COMP/M.6166 Deutsche Borse/ NYSE Euronext; COMP/M.6570 UPS/TNT Express.

¹¹ See, for example Case M.7018 (Telefonica Deutschland/E-Plus); Case M.6992 (Hutchison 3G UK/Telefonica Ireland); Case M.6497 (Hutchison 3G Austria / Orange Austria).

wholesale contract. Given that Virgin Media is a significant quad play competitor of the merged entity, Sky expects that its concerns in relation to permutation (a) and (c) would also apply to Virgin Media once its existing contract comes up for renewal. To the extent that Virgin Media challenges the Provisional Findings in relation to permutation (b), those submissions may also be relevant to the CMA's assessment of permutation (c).

2(C) Corrections are required to address the flaws in the overarching analytical approach in the Provisional Findings

- 2.15 The Provisional Findings in relation to wholesale mobile services are undermined by serious flaws in the overarching analytical approach. These errors must be corrected for the CMA to draw reliable conclusions on this theory of harm.
- 2.16 First, the Provisional Findings inappropriately focus on an analysis of total foreclosure and relegate partial foreclosure merely to a secondary permutation that is then dismissed cursorily and speculatively.
- 2.17 This stems from an insufficient analysis of the impact of the Merger on the relevant trade-offs around withholding or restricting supply for the merged entity. As explained by CRA,¹² the Merger combines two complementary and large revenue streams in fixed and mobile services, whereas, pre-merger, EE was reliant primarily on revenue from mobile services. As such, the Merger changes the trade-off for EE between the wholesale revenues that could be gained from providing wholesale mobile services to a fixed MVNO and the downstream margins (mobile and fixed) that could be gained from capturing retail customers diverted from fixed MVNOs. As the potential downstream margins would be larger post-merger, the Merger has the potential to change the wholesale access terms that the merged entity would be willing to offer to fixed MVNOs compared to EE pre-merger. Total foreclosure is an extreme outcome of these changed incentives, and partial foreclosure the more obvious case.
- 2.18 The primary reason provided for dismissing partial foreclosure is an unfounded claim that total foreclosure would be more effective if the merged entity wanted to cause harm to fixed MVNOs. The Provisional Findings state that if the merged entity wanted to win a wholesale tender, it would bid to win and, if it wanted to foreclose, it could achieve foreclosure more readily by refusing to bid at all. As explained by CRA,¹³ post-merger, the merged entity will still weigh up the gains from both wholesale revenues and retail margins. As such, the most likely concern arising from the Merger is that it will increase the incentive to bid less aggressively and thereby raise rivals' costs, rather than eliminate the incentive to supply altogether.¹⁴ Partial foreclosure therefore requires detailed analysis as a standalone concern.
- 2.19 Second, in assessing foreclosure strategies, it is critical that the appropriate analytical tool is utilised. In the Provisional Findings, a vertical arithmetic ("VA") approach is used to assess total foreclosure. Whilst VA can be used to achieve an initial approximation of changed incentives in some circumstances, it is also a fairly crude instrument that cannot take systematically into account the strategic responses of competitors. As described further below, the Merger changes the behaviour of competitor MNO hosts in a way that cannot be captured in a VA approach. The VA approach also does not assist in quantifying the incentives to engage in a partial foreclosure strategy. A proper equilibrium analysis¹⁵ is

¹² Annex 1, Paragraph 17.

¹³ Annex 1, Paragraph 36.

¹⁴ This conclusion is supported by the dissenting Members.

¹⁵ This would involve a coherent, structured analysis of the strategic interactions in the wholesale and retail markets for both the merged entity and its competitors.

necessary to assess both partial and total foreclosure risks. The CMA should proceed on this basis in order to draw reliable conclusions on the likelihood of SLCs arising.

2(D) A detailed assessment of partial foreclosure of fixed MVNOs in future contracts is required before dismissing a SLC

A detailed analysis of partial foreclosure of fixed MVNOs in future contracts as a standalone concern is essential, but is dismissed too readily in the Provisional Findings. These conclude that the Merger is not likely to lead to partial foreclosure of fixed MVNOs under any future contracts with the merged entity. However, there is insufficient analysis of this aspect of the theory of harm, addressed in a mere two and a half pages in the Provisional Findings.

- 2.20 The grounds for dismissal of this partial foreclosure theory are unsound.
- 2.21 First, the assessment of partial foreclosure is treated as a secondary variant of total foreclosure. It is then dismissed as a less effective foreclosure strategy. For the reasons set out above, this is inappropriate; a detailed standalone assessment is required, on the basis of a full equilibrium analysis. A standalone assessment would need to consider all forms of partial foreclosure that could raise rival fixed MVNOs' costs of operation – this would encompass both price and quality. In addition, given that the Provisional Findings treat partial foreclosure as a secondary variant of total foreclosure, some of the errors of analysis in the assessment of total foreclosure may also lead to an underestimation of the risk of partial foreclosure.¹⁶ These errors are discussed further in sub-sections 2(E) to 2(G) below.
- 2.22 Second, the Provisional Findings conclude that a partial foreclosure strategy based on the merged entity degrading the quality of services provided within the lifetime of the contract would be unlikely.
- 2.22.1 This is based first on the suggestion that fixed MVNOs have not stated that they would not procure wholesale mobile services from BT post-merger. ✂¹⁷
- 2.22.2 The Provisional Findings go on to state that fixed MVNOs procure wholesale inputs from BT in the fixed telecoms context and therefore are willing and able to deal with BT as a supplier. Sky notes that as BT is the incumbent supplier in fixed broadband, with regulatory obligations to supply third parties, Sky has no choice but to deal with BT if it wishes to provide broadband services. In addition, Sky has some protection under the existing regulatory framework from unfavourable conduct by BT in fixed broadband.¹⁸ There is currently no such protection in mobile services. The necessity of trading with BT as an essential supplier in fixed broadband is not relevant to an assessment of BT's ability and incentive to worsen terms within a wholesale mobile services contract.
- 2.22.3 Finally, it is suggested that fixed MVNOs could seek to protect themselves contractually from quality degradation during the contract. Such protections are hard to codify,¹⁹ but, more importantly, fixed MVNOs have no certainty that the merged entity would be willing to agree to such terms in the context of a commercial negotiation post-merger. The bargaining power of fixed MVNOs is substantially overestimated in the Provisional Findings. This is evident particularly

¹⁶ Annex 1, Paragraph 48ff.

¹⁷ ✂

¹⁸ Sky notes, however, that such protection is imperfect, as set out in Sky's submissions to the CMA on wholesale broadband and mobile backhaul in the current merger review process, and also submissions made as part of Ofcom's ongoing Strategic Review of Digital Communications.

¹⁹ ✂

from the suggestion that new fixed MVNOs would be able to negotiate more favourable wholesale agreements with the merged entity than Virgin Media – EE's largest and longest-standing existing MVNO. In practice, as set out by CRA in Annex 1²⁰, the merged entity is likely to have both the ability and an increased incentive to 'sabotage' services provided to fixed MVNOs, for example by lowering any aspect of service quality that cannot be defined contractually. These merger effects could raise costs for fixed MVNOs either because (i) they use the merged entity's wholesale mobile services and face degraded quality or (ii) they become reluctant to rely on BT/EE as an access provider, thereby reducing competition in the market for wholesale services.

- 2.23 Third, as the Provisional Findings heavily rely on the analysis of total foreclosure in dismissing the likelihood of partial foreclosure, the errors in the assessment of total foreclosure also impair the CMA's analysis of partial foreclosure.

2(E) Assessment of ability to foreclose: the limited ability of fixed MVNOs and alternative MNO hosts to address the lost wholesale competition post-merger

- 2.24 In this sub-section and the following sub-sections 2(F) and 2(G), Sky addresses the flaws in the Provisional Findings' assessment of total foreclosure, noting (as above) the read-across to assessment of partial foreclosure.

- 2.25 The merged entity is likely to have the ability to engage in total or partial foreclosure post-merger, in light of (i) MVNOs' limited bargaining power to extract competitive terms (ii) the nature of the bidding process and bidders' behaviour and (iii) the changed dynamics of wholesale competition post-merger.

- 2.26 The Provisional Findings conclude that if the merged entity engaged in total foreclosure, fixed MVNOs would still be able to obtain wholesale mobile services from other MNOs. Although the Provisional Findings acknowledge that fixed MVNOs could face higher wholesale prices and/or lower quality for their wholesale mobile inputs post-merger as a result of total foreclosure, no conclusive view is expressed about the significance of this impact.²¹

- 2.27 It is suggested that the impact of the merged entity refusing to supply fixed MVNOs will be offset by MVNOs' ability to extract competitive terms during the tender process, as well as the existence of alternative hosts. This assessment is commercially naïve and logically flawed. It is based on an overestimation of MVNOs' bargaining power, a mischaracterisation of the bidding process and bidders' behaviour and a lack of assessment of the changed dynamics of wholesale competition post-merger. These factors are explained further below.

The ability of MVNOs to extract competitive wholesale terms is limited

- 2.28 In practice, MVNOs' ability to extract competitive wholesale terms during a tender process is already limited pre-merger, and will be significantly more constrained post-merger. The suggestion in the Provisional Findings that MVNOs can mitigate somehow the effects of the loss of EE from the hosting market post-merger through control of the tender process is incorrect. It is also erroneous to suggest that MVNOs' bargaining power will enable them to counteract the merged entity's partial foreclosure strategies.

- 2.29 ✂²² ✂

²⁰ Annex 1 paragraphs 63 and 64.

²¹ Paragraphs 14.121 and 14.122.

²² ✂

- 2.30 ~~23~~ ~~24~~
- 2.31 ~~25~~ ~~26~~ Post-merger, with fewer willing MNO hosts, it would be ~~27~~ difficult to induce a sufficient number of MNOs to engage, in order to run an effective tender process.
- 2.32 Further, the willingness (or otherwise) of a MNO to host a MVNO is closely reflected in the nature of the wholesale terms it is willing to offer. The MNO can directly constrain and implicitly shape the MVNO's commercial strategy (and therefore the MVNO's competitiveness in the retail market) through the structure of the commercial terms in the wholesale agreement. Ultimately the MVNO can do very little to counter this if it does not have reasonable alternative suppliers.
- 2.33 ~~27~~ ~~28~~
- 2.34 ~~29~~ ~~30~~
- 2.35 ~~31~~
- 2.36 For the reasons set out above, contrary to the conclusions reached in the Provisional Findings, fixed MVNOs will not be able to contain the ability of the merged entity to engage in partial or total foreclosure strategies, through control of the bidding process. This is compounded by the nature of the bidding process and the changed competitive dynamics in the wholesale mobile services market that fixed MVNOs would face post-merger.

The nature of the bidding process and bidders' behaviour

- 2.37 In practice, the nature of the bidding process and bidders' behaviour is such that the merged entity is able to foreclose, contrary to the suggestions in the Provisional Findings.
- 2.38 First, contrary to the Provisional Findings that there is considerable uncertainty as to whether EE could credibly withdraw from bidding to supply fixed MVNOs post-merger, Sky considers that this possibility would be clear to the other MNOs. Fixed MVNOs' reluctance to deal with the merged entity will also be evident. This will inevitably soften the wholesale bidding behaviour of the remaining MNOs.
- 2.38.1 As explained by CRA, the suggestion that EE cannot credibly withdraw from the market ignores the nature of MNO competition and the structure of the bidding process: a series of repeat tenders amongst a small number of sophisticated players.³² Since the CMA has doubts as to the ability of EE to withdraw from hosting fixed MVNOs it is even more important to conduct a proper analysis of incentives to raise rivals' costs through a partial foreclosure strategy.
- 2.38.2 The Provisional Findings also suggest that the merged entity might underplay its presence in the wholesale market whilst still entering into negotiations with

23 ~~23~~

24 ~~24~~

25 ~~25~~

26 ~~26~~

27 ~~27~~

28 ~~28~~

29 ~~29~~

30 ~~30~~

31 ~~31~~

32 Annex 1, Section 3.1.

MVNOs in order to obtain a 'better' deal than if it was visibly competing.³³ A 'better' deal for the MNO host is inevitably a less competitive deal from the MVNO's perspective and therefore this offers no comfort in addressing the reduction of wholesale competition.

- 2.38.3 The Provisional Findings note that MNOs will be more willing to bid and offer compelling wholesale terms when they are concerned that the MVNO might otherwise go to a rival MNO and be successful in the market. The Provisional Findings suggest that the MNO's incentives to host may therefore be higher, the better the quality of the contract the MNO expects the MVNO to receive should it not bid.³⁴ Were this to be the case, the removal of EE with the highest quality 4G network from the fixed MVNO tender process, would have a dampening effect on other MNOs' incentives to bid and to bid competitively.
- 2.38.4 Equally, as acknowledged by the dissenting Members, the reluctance of fixed MVNOs to deal with the merged entity will be evident to alternative MNO hosts both from the detailed and public concerns raised by fixed MVNOs in the CMA's review of the Merger so far, as well as the ongoing disputes and concerns raised by the same players in the context of BT's supply in fixed telecoms markets.³⁵ This would inevitably reduce competitive tension in the hosting market, and therefore the competitiveness of wholesale offers that other MNOs would put forward.
- 2.39 Second, it is inappropriate for the CMA to assume that the impact of total or partial foreclosure strategies will be limited, relying on the purported closeness of competition between MNO hosts pre-merger. ✂³⁶ ✂
- 2.39.1 Given the bespoke nature of individual MVNO deals and the broad range of structures³⁷, no one deal with a major MVNO is likely to be the same. As such, like-for-like comparisons are extremely difficult.
- 2.39.2 ✂³⁸ ✂
- 2.39.3 ✂
- 2.40 Section 3.3 of the CRA paper further explains why pre-merger bids are entirely uninformative about the nature of post-merger bids. In particular, even if the delta between winning and second placed bids has been small in previous tenders, it is incorrect to infer that EE failing to bid at all or bidding more weakly post-merger would have a small impact on wholesale prices post-merger.

The changed competitive dynamics in the wholesale mobile services market post-merger

- 2.41 Judged in the context of a proper understanding of the nature of the bidding process, the impact of foreclosure strategies is further compounded by changes in the competitive dynamics in the wholesale mobile services market arising from the Merger. The existence

³³ Paragraph 14.28. Sky notes that any supporting material for this statement has been redacted in the published version of the Provisional Findings and so Sky has not been able to engage with this. Separately, Sky notes that a MNO might engage in a tender simply to gain commercial insight into a MVNO's commercial strategy.

³⁴ Paragraph 13.48.

³⁵ See paragraphs 14.278 and 14.279 of the Provisional Findings.

³⁶ Paragraph 14.109.

³⁷ These can range from simple reseller arrangements to full MVNO arrangements, where the MVNO relies on the MNO simply for the radio access network.

³⁸ ✂

of alternative MNO hosts would not neutralise foreclosure by the merged entity post-merger.

- 2.42 The impact of the Merger on competitor responses requires formal modelling in the form of an equilibrium analysis. By contrast, the VA approach utilised in the Provisional Findings cannot account for competitor responses or for changes in the competitive dynamics in the wholesale mobile services market post-merger.³⁹ The remaining MNOs will expect a softening of EE's bids and/or EE's complete withdrawal from hosting fixed MVNOs post-merger and adjust their bidding behaviour accordingly.⁴⁰ The credibility of the remaining MNO hosts will also be undermined post-merger, as a result of the Merger's impact on other inputs, such as mobile backhaul.
- 2.43 The incentives and ability of alternative MNO hosts to offer wholesale mobile services were dissimilar to those of EE pre-merger and will be undermined further post-merger.
- 2.43.1 As previously described to the CMA,⁴¹ in Sky's view, ✂
- 2.43.2 Pre-merger, EE was the most experienced and willing MNO host, with the fastest and most extensive 4G network, supported by the largest spectrum holdings. As acknowledged by the CMA in the Provisional Findings, it was a 'strong competitor' in the provision of wholesale mobile services. ✂⁴² ✂
- 2.43.3 Post-merger, adopting the correct counterfactual, if the merged entity refused to supply or significantly worsened its wholesale terms, there would be only two alternative MNO hosts available to fixed MVNOs: Vodafone and H3G/O2. The ability and incentives of these MNOs to offer competitive hosting terms can be expected to be reduced post-merger.
- 2.43.4 Vodafone: ✂ In general, Vodafone has not been the winner of recent MVNO tenders and some of its key MVNOs have brought their hosting arrangements to an end. TalkTalk has moved its MVNO business to Telefonica and the termination of Vodafone's hosting arrangement with Sainsbury's was recently announced.⁴³ ✂ As noted by CRA, wholesale competition between fixed MNOs (Vodafone and the merged entity) is likely to be weak post-merger, as hosting fixed MVNOs can be expected to soften the host MNO's retail pricing for fixed-mobile bundles.⁴⁴
- 2.43.5 H3G/O2: O2 is Sky's current MNO host. ✂ In relation to network quality, Sky also notes that the Merger increases the gap between the merged entity and the remaining MNOs. O2 is already subject to some spectrum constraints, particularly in relation to high-frequency spectrum which is immediately usable. Whilst O2's spectrum position will be improved after its merger with H3G, its spectrum portfolio will still not be on a par with EE's. With no spectrum cap proposed for Ofcom's upcoming auction of 2.3 GHz and 3.4 GHz spectrum and with the supporting device ecosystem for this spectrum yet to emerge, there is also no guarantee that H3G/O2's spectrum position will improve in the near-term. H3G/O2's network quality may be further undermined post-merger by BT choosing

³⁹ See Sections 2.4 and 4 of Annex 1. Sky does not engage here with the detail of the VA analysis in the Provisional Findings, but notes that it rests on a number of assumptions that are largely arbitrary.

⁴⁰ Annex 1, Paragraph 40.

⁴¹ ✂

⁴² ✂

⁴³ See:
<http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/telecoms/11931499/Sainsburys-mobile-customers-left-hanging-as-deal-with-Vodafone-ends.html>

⁴⁴ Annex 1, Section 4.2.1.

to favour its new downstream mobile division in provisioning and pricing of mobile backhaul on which H3G/O2 will also need to rely.

- 2.44 In any event, even if the H3G/O2 Merger did not go ahead and H3G remained an independent MNO, there are doubts as to its strength as a competitive constraint in the hosting market, given it has been an inactive host to date. Further, its network rollout and spectrum holdings compare unfavourably to EE's. Post-merger the gap between the spectrum holdings and network quality of the merged entity versus other MNOs is likely to widen further. The CMA's suggestion that H3G might be willing to bid more often where EE refuses to bid⁴⁵ is unsupported conjecture. It is not based on any rational assessment of incentives, and therefore should not form the basis for the CMA's provisional finding. Moreover, the willingness of H3G to enter the market where pre-merger it did not would itself be a sign that the hosting market was less competitive than pre-merger.
- 2.45 Finally, it is insufficient for the CMA to assume that pure play MNOs will have greater incentives to host fixed MVNOs in the event that fixed-mobile sales increase. It is true that pure play MNOs may consider hosting a fixed MVNO as an indirect way of generating revenue from increasing demand for fixed-mobile bundles. However, if the CMA considers the correct counterfactual, H3G/O2 would be the only pure play MNO host in the market and therefore would face no competitive constraint from rivals. As CRA notes, this will inevitably have a weakening effect on the access terms offered by pure play MNOs.⁴⁶
- 2.46 For the reasons set out above, the Provisional Findings underestimate the merged entity's ability to foreclose fixed MVNOs. Despite this, the Provisional Findings conclude that whilst such MVNOs would still be able to obtain wholesale deals, they would likely be on worse terms. A more accurate assessment of the merged entity's ability to foreclose would expose a more significant negative impact on the competitiveness of the wholesale terms that MVNOs are likely to obtain post-merger.

2(F) Assessment of incentives to foreclose: the likely take-up of fixed-mobile bundles post-merger

- 2.47 In addition to the evidence regarding the merged entity's ability to foreclose, there is also sufficient evidence regarding the likely take up of fixed-mobile bundles to support a finding that the merged entity will be likely to have the incentive to foreclose fixed MVNOs.
- 2.48 The evidence provided to the CMA during the merger process demonstrates that fixed-mobile cross-selling is likely to become more important in the short to medium term in the UK. As well as the trends already visible in other Member States where the incumbent fixed operator also has a mobile arm, cross-selling fixed and mobile services is a stated objective of BT in entering into the Merger and underpinning some of the proposed transaction synergies.
- 2.49 In these circumstances, Sky fails to understand the reluctance in the Provisional Findings to rely on forward-looking projections of market developments provided during the merger review. The CMA should not set itself an unduly high standard of proof.
- 2.50 The merger assessment required of the CMA is inherently forward-looking, and therefore involves a degree of speculation about the future impact of the transaction under consideration, having regard to all available evidence.⁴⁷ In moving to its final report, it is

⁴⁵ Paragraph 14.98.

⁴⁶ Annex 1, Section 4.2.2.

⁴⁷ The European Commission makes this position clear in relation to its own merger assessment process in its Guidelines on the assessment of non-horizontal mergers (2008/C 265/07), paragraph 20, stating that "In assessing the competitive effects of a merger, the Commission compares the competitive conditions that would result from the notified merger with the conditions that would have prevailed without the merger. In most cases the competitive conditions existing at the time of the merger constitute the relevant comparison for evaluating the

important that the CMA is willing to rely on forward-looking evidence over which there is broad industry consensus, particularly in the area of the growth in fixed-mobile bundles and single sourcing. Where there is the risk of a SLC and the CMA considers that there is doubt over forward-looking evidence, in the interests of preserving effective competition post-merger, it is prudent for the CMA to err on the side of caution as there is a one-off opportunity to address this ex ante. This should lead it to identify a SLC and an appropriate remedy, rather than allowing a SLC to emerge post-merger, which then cannot be rectified retrospectively.

- 2.51 Extensive evidence has been provided during the merger review of the likely increased prevalence of fixed-mobile bundles and single-sourcing post-merger:
- 2.51.1 As regards the importance of bundles, Ofcom itself notes at paragraph 4.14 of its Phase II submission, summarising what it has published in its Strategic Review of Digital Communications discussion document that *“the bundling trend in telecoms markets looks set to continue as the industry prepares to make quad-play bundles (telephony, fixed broadband, TV, mobile phone) a core offering.”*
- 2.51.2 Individual operator forecasts, including those of the parties are stated to be *“consistent with very substantial growth in the number of fixed-mobile customers over next few years”*.⁴⁸ Further, in aggregate, the forecasts are stated to *“imply take up by 2019 greater than in France and Spain currently which would represent substantial proportion of households”*.⁴⁹
- 2.51.3 BT’s internal documents showed BT expected significant growth in sales of fixed-mobile bundles⁵⁰ as also reflected in its anticipated revenue synergies.
- 2.52 BT is already pricing its mobile service keenly and with an in-built discount for customers purchasing other products: its entry-level 4G plan is £5 per month for BT broadband customers. Non-BT broadband customers are charged twice as much. Sky would expect this behaviour to become more pronounced and drive fixed-mobile single sourcing post-merger.
- 2.53 Moreover, the pay-off from engaging in a foreclosure strategy is more certain than the Provisional Findings suggest.⁵¹ BT and EE have shown commitment to differentiating themselves from competitors through head-to-head comparisons about the superior quality of their networks. EE’s 4G marketing campaigns have been built on claims to have the biggest and fastest 4G network. Likewise, BT’s fixed broadband campaigns have also encompassed superior speed claims (for fixed fibre broadband). On the basis of this past practice, Sky would expect BT to remain strongly committed to retain its differentiator of access to the biggest and fastest 4G network post-merger. Offering hosting services to its closest fixed-mobile competitors would extinguish this differentiator, unless the range and quality of services offered was limited or degraded vis-à-vis its own retail mobile customers. Withholding hosting services from fixed MVNOs would offer BT certainty that it could continue to distinguish itself from its fixed competitors on grounds of network coverage and quality.
- 2.54 In assessing likely recapture of fixed-mobile customers of foreclosed MVNOs, the Provisional Findings suggest that it is probable that the merged entity would continue to

effects of a merger. However, in some circumstances the Commission may take into account future changes to the market that can reasonably be predicted”.

⁴⁸ Appendix H, H9, paragraph 20.

⁴⁹ Appendix H, H10, paragraph 24.

⁵⁰ Appendix H, H13, paragraph 26.

⁵¹ At Paragraph 14.180, the Provisional Findings suggest that the merged entity would be uncertain about the benefits of a foreclosure strategy.

face multiple fixed-mobile competitors and therefore it could only recapture a limited number of retail customers.⁵² Again, this conclusion is based on unsupported speculation that H3G/O2 would choose to enter the fixed telecoms market themselves and/or that Vodafone would be incentivised to host fixed MVNOs ~~✗~~⁵³ ~~✗~~

2(G) Assessment of effects: the SLC gives rise to effects in the wholesale and retail markets

- 2.55 It is clear that the total or partial foreclosure strategies employed by the merged entity described above would give rise to effects in the wholesale and retail markets.
- 2.56 The Provisional Findings acknowledge that fixed MVNOs are likely to face worse wholesale supply terms post-merger in the event of the merged entity successfully engaging in a total foreclosure strategy.
- 2.57 The downstream effects of a total foreclosure strategy are not considered. The downstream effects of a partial foreclosure strategy are briefly considered and dismissed on the basis that there is unlikely to be a substantial effect in the retail market.

Effects on the wholesale market

- 2.58 In relation to the wholesale market, the Provisional Findings identify negative effects on wholesale customers in terms of higher wholesale prices and/or reduced quality. As described above, a proper assessment of the merged entity's ability and incentive to foreclose fixed MVNOs would reveal that more pronounced negative effects at the wholesale level are likely to arise – whether the merged entity were to engage in a total or partial foreclosure strategy. This directly impacts the MVNOs' costs of running a mobile business and should not be discounted. Indeed, the dissenting Members highlight that the impact of input foreclosure in wholesale mobile services on wholesale competitors, in the form of higher prices and/or reduced quality is sufficient to establish a SLC.⁵⁴
- 2.59 It is important that the CMA does not discount the impact on competitors of the merged entity and attach insufficient weight to evidence provided by them. In a vertical merger, such as the present case, where a number of the theories of harm rest on input foreclosure, it is inevitable that the affected customers in wholesale markets are also competitors of the merged entity in downstream retail markets. It is therefore important that due weight is placed on the impact on competitors/wholesale customers.⁵⁵

Effects on the retail market

- 2.60 Negative effects would also arise in relation to downstream retail competition, and therefore for final consumers. MVNOs, and particularly fixed MVNOs going forward, play an important role as a competitive constraint in the retail market.
- 2.61 The Provisional Findings conclude that partial foreclosure of fixed MVNOs in future contracts is unlikely to result in effects in the retail market.⁵⁶ There is a very limited

⁵² Paragraph 14.169.

⁵³ Paragraph 14.169.

⁵⁴ Paragraph 14.279.

⁵⁵ The CMA's duty in a Phase II review of an anticipated merger is set out in section 36(1) of the Enterprise Act 2002 as being to decide "...whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within **any** market or markets in the UK for goods or services." (emphasis added). This requires the restoration of competition for the benefit of customers in any affected market, including the wholesale market.

⁵⁶ Paragraph 14.274.

description of the reasoning behind this conclusion, although a parallel is drawn with the reasoning in relation to partial foreclosure of Virgin Media under its existing contract. Those reasons include the fact that Virgin Media was considered to be unlikely to impose a significant competitive constraint on other mobile operators and that, in the event of fixed-mobile bundles becoming increasingly important, multiple other players exist in the market.

- 2.62 This conclusion is incorrect. Fixed MVNOs are likely to be sufficiently important to retail competition, such that the merged entity deploying partial or total foreclosure strategies would give rise to appreciable effects in the retail market.
- 2.63 The Provisional Findings acknowledge the importance of fixed MVNOs for retail competition to some degree. For example, the Provisional Findings note that fixed MVNOs have ambitious plans to reach scale in the market,⁵⁷ and yet their importance in the retail market is still discounted when assessing the effects of the merged entity's foreclosure strategy.
- 2.64 In practice, the ongoing importance of MVNOs in providing a competitive constraint in standalone retail mobile sales in the UK is widely recognised and may not be evident from historic market shares alone.⁵⁸
- 2.64.1 During its Phase II hearing, Ofcom discussed with the CMA the importance of MVNOs to retail competition. The hearing summary notes that, *"Ofcom said that it agreed with the CMA that MVNOs delivered benefits to consumers. It mattered that MVNOs had access to a good wholesale market, especially to the extent that multiplay bundles were important."*⁵⁹
- 2.64.2 These are points that Ofcom also made in its Phase II submission, noting for example that, *"[c]ompetition between national wholesalers supports good consumer outcomes through direct competition at the retail level between vertically integrated providers and through competition to supply MVNOs which then compete in the retail market...it is possible that greater competition between national wholesalers to supply MVNOs could provide MVNOs with the ability and incentive to compete more strongly at the retail level."*⁶⁰
- 2.65 Furthermore, fixed MVNOs are particularly important in the current and prospective supply of fixed-mobile bundles and single sourcing. Indeed, fixed MVNOs are likely to be more important players in the retail market than other MVNOs, delivering products that consumers increasingly demand and with a better quality service. Firstly, they are mass-market, rather than niche, players in line with their existing mass-market fixed telecoms and television businesses. They have all the quad play components to compete head-to-head with the merged entity, provided they can source wholesale fixed and mobile inputs on competitive terms. They have a different business profile from pure play MNOs and may therefore offer more maverick competition. Secondly, they can leverage both their existing marketing acumen and customer relationships, as well as their technical infrastructure and existing core network in order to deliver a good quality service and achieve scale.
- 2.66 Ensuring that fixed MVNOs can compete effectively is crucial in preserving choice for consumers, and is especially important at a juncture when fixed-mobile bundles are likely to become more significant. It is therefore important to future retail competition in

⁵⁷ Paragraph 14.179.

⁵⁸ For example, TalkTalk has recently announced rapid growth in its mobile customer base – TalkTalk interim results announced on 11 November 2015. See <http://www.talktalkgroup.com/investors/results-centre>.

⁵⁹ Ofcom hearing summary, paragraph 125.

⁶⁰ See paragraph 4.29 of Ofcom's Phase II submission.

standalone mobile services and in fixed-mobile bundles/single sourcing that the ability of fixed MVNOs to compete is preserved.

2(H) The SLC can be addressed in a targeted and proportionate manner

- 2.67 The key impacts of the SLC identified above are (i) fixed MVNOs are significantly less likely to obtain attractive wholesale terms or even a wholesale offer from the ~~X~~ MNO host in the market pre-merger; and (ii) competitive tension in the remainder of the wholesale hosting market will be reduced, such that fixed MVNOs will also obtain less favourable wholesale terms (price and/or quality) from alternative MNO hosts.
- 2.68 Remedying this SLC requires a solution that would create repeatable wholesale offers to fixed MVNOs on attractive regulated wholesale terms, available as and when existing wholesale deals come up for renewal. This would enable fixed MVNOs to avail themselves of wholesale hosting by the merged entity, despite any incentives not to host them post-merger. Setting up a regulated reference offer would alleviate MVNOs' concerns as to the merged entity's reluctance to agree competitive wholesale terms in commercial negotiation. Transparency of the existence of the remedy would also make clear to alternative hosts that EE remains a potential host for fixed MVNOs and therefore that alternative hosts would need to offer attractive wholesale terms in order to win MVNO business.
- 2.69 There are precedent wholesale hosting remedies from the European Commission for addressing competition concerns identified in mobile markets and as such the CMA would not be starting from a blank page. This should give the CMA comfort that a remedy solution can be identified to resolve the SLC created by the Merger in this case. Nevertheless, Sky notes that previous hosting remedies have primarily been designed to address an immediate loss of retail competition in horizontal mergers, unlike in the present case. Therefore the objectives and structure of the remedy required in the present case will have small but important differences.
- 2.70 At a high level, Sky considers that it would encompass the following elements:
- 2.70.1 a standing reference offer on regulated terms;
 - 2.70.2 the merged entity to make available up to a specified percentage of its capacity for wholesale to MVNOs until capacity is used up (capacity could be released for wholesale again if existing wholesale arrangements come to an end);
 - 2.70.3 the charging structure to be on the basis of variable usage rates: to approximate the nature of the charging structures evident in existing MVNO agreements in the UK market today;
 - 2.70.4 wholesale rates to be set on a retail minus basis, in order that MVNOs remain competitive in the retail market over time;
 - 2.70.5 service parity with the merged entity's retail customers;
 - 2.70.6 an independent dispute resolution mechanism; and
 - 2.70.7 Ofcom oversight of the process.
- 2.71 This would meet the CMA's remedy criteria:⁶¹
- 2.71.1 Effective in addressing the reduced competitive tension in the hosting market with a high degree of certainty: the reference offer would give certainty to EE remaining a competitive force in the MVNO hosting market and dealing on competitive terms.

⁶¹

Paragraph 1.7 and 1.8 of CC8 *Merger Remedies: Competition Commission Guidelines*.

It would also maintain competitive tension in the wholesale hosting market vis-à-vis alternative MNO hosts.

- 2.71.2 Specific: the reference offer will specify the key terms and conditions for offering wholesale services. Existing wholesale agreements offer a template which could be drawn upon.
- 2.71.3 Speed of implementation: the reference offer can be agreed with the CMA and made available immediately.
- 2.71.4 Timely: the reference offer could come into force immediately, thereby maintaining hosting rivalry. In any event, the remedy would only need to be utilised as and when contracts come up for renewal. ✕
- 2.71.5 Practicable: as noted above, hosting remedies have been used multiple times by the European Commission in mobile mergers. If key terms are specified in the reference offer, then ongoing monitoring would not be required. Ofcom could play a role in resolving disputes if they arise, as it does in the fixed broadband context.
- 2.71.6 Proportionate: a limitation on the capacity to be allocated to wholesale hosting under the reference offer would allow the merged entity to efficiently utilise the remainder of its capacity. Further, a variable usage model would enable MVNOs to utilise the amount of capacity they require and may allow more MVNOs to be served, rather than the merged entity allocating large chunks of capacity on a fixed volume basis, which might be an inefficient use of capacity.

3. Small cells

- 3.1 Chapter 12 of the Provisional Findings addresses loss of dynamic retail competition via (i) strategic bidding for spectrum by the merged entity; and (ii) the ability of third parties to rely on existing spectrum holdings. However neither limb of the analysis is directed at small cells and the analysis suffers from material flaws. Chapter 16 of the Provisional Findings addresses wholesale input foreclosure (in terms of site access and backhaul) of small cell deployments, but also suffers from material flaws.
- 3.2 A lack of focus on small cells and flaws in the analysis ultimately contribute to the provisional conclusion that rivals can compete strongly for customers and that therefore there will be no impact on retail mobile markets in the medium to long term.
- 3.3 Fundamentally, the Provisional Findings fail to accord due weight to the importance of small cell deployments due to an erroneous view that the deployment of new spectrum can affect MNOs' capacity only in the medium to long term. Small cell deployments, however, are strategically important, in the short to medium term, ✕ to respond to network capacity, coverage and speed issues and ultimately to retail competition in mobile services.
- 3.4 In light of the importance of small cells to future retail competition and the flaws in the Provisional Findings, Sky invites the CMA to fully investigate the combination of the loss of dynamic retail competition in spectrum and wholesale input foreclosure in respect of the deployment of small cells.
 - 3.4.1 In terms of the loss of dynamic retail competition, the CMA should consider the merged entity's ability to pursue a foreclosure strategy in relation to small cells ✕

by winning readily usable high frequency spectrum⁶² in the Public Sector Spectrum Release (PSSR) auction. Further the CMA should consider whether the spectrum third parties hold can actually be used to deploy small cells or whether it is likely to be used to increase capacity and speeds at the macro layer only.

- 3.4.2 In terms of wholesale input foreclosure, the CMA should consider further the availability of suitable sites for small cell deployment and the fact that Openreach does not currently provide any fibre backhaul products for small cell connectivity and, absent regulatory intervention, is unlikely to do so in future.
- 3.5 Looking holistically at the combination of these issues and correcting the flaws in the analyses, the Merger gives rise to a SLC in the retail market for mobile services as it gives the merged entity the ability and incentive to foreclose deployment of small cell networks by its rivals.
- 3.6 This SLC is moreover exacerbated by the foreclosure of fixed MVNOs in wholesale mobile hosting set out above, as the ability of fixed MVNOs to deploy counter strategies post-merger in the event they cannot obtain competitive hosting terms is diminished.
- 3.7 Sky discusses in more detail below first the importance of small cells for competition and then turns to the flaws and omission of small cells in the analysis of loss of dynamic retail competition. Sky then sets out the flaws in the analysis of wholesale input foreclosure in respect of small cells before discussing how foreclosure in the deployment of small cells is likely to result in worsening quality and/or increasing prices for consumers.

3(A) The importance of small cells

- 3.8 The Provisional Findings underestimate the importance of small cells because they fail to properly take into account: (i) evidence on the projected volumes of small cells; (ii) how small cells fit into the upgrade path of mobile networks; and (iii) the Provisional Findings underestimate the importance of small cells due to an erroneous view that deployment of new spectrum can affect MNOs' capacity over the medium to long rather than short to medium term⁶³.
- 3.8.1 In terms of projected volumes, Ofcom projects that from 2012 onwards small cell numbers will grow at 10% per year compared to macro sites growing at only 1% per year.⁶⁴ The projected volumes and the yearly growth of small cells in absolute terms mean that small cells will be the key means to increase capacity and speeds of mobile services sooner rather than later. The MNOs' submissions confirm Ofcom's projections for substantial growth in small cells.⁶⁵ The Provisional Findings do not however place sufficient weight on this evidence.

⁶² In terms of network architecture and value, frequencies can be separated into three ranges of sub 1 GHz, 1 GHz to 2.1 GHz and above 2.1 GHz. High frequencies above 2.1 GHz are likely to be used mainly in small cell layers. BT/EE has a total of 125 MHz of spectrum at high frequencies above 2.1 GHz (about 65%). This contrasts with 65MHz for Vodafone (about 35%) no holding for a combined Three/O2. Readily usable high frequency spectrum is the spectrum above 2.1 GHz which includes the 40 MHz in the 2.3 GHz band that is up for sale in the PSSR auction, as well as the existing spectrum holdings of Vodafone and BT/EE in the 2.6GHz band. This spectrum is readily usable because it is supported on existing devices. The spectrum in the 3.4 GHz band available in the PSSR auction is not readily usable because it is unlikely to be supported by devices in the short to medium term.

⁶³ Paragraph 12.9 Provisional Findings; paragraph 67, G19, Appendices.

⁶⁴ Paragraph 5.30, Provisional Findings.

⁶⁵ Paragraph 16.56, Provisional Findings. Also, paragraph 9, Summary of hearing with Vodafone on 3 August 2015 "[...] A key trend was the enormous growth in data going forward, so increasing the capacity of the network was key through fibre backhaul and making the network denser. [...]".

3.8.2 Nor do the Provisional Findings place sufficient weight on the importance of small cells to MNOs' planned network investments.⁶⁶ Capacity is added to mobile networks in stages, with the least expensive stages undertaken first. Upgrading macro sites is generally cheaper than building several small cell sites from scratch to cover the same area. Therefore, macro site upgrades (such as sectorisation, or adding new spectrum bands) are deployed first before small cell deployments. Since macro site upgrades are unlikely to deliver sufficient capacity on the network to satisfy demand for high volumes and speeds of data, small cells are likely to be deployed sooner rather than later.⁶⁷

3.8.3 ✂⁶⁸ ✂

3(B) Availability of high frequency spectrum for small cell deployment

3.9 The Provisional Findings assess third parties' ability to compete against the merged entity's spectrum capabilities⁶⁹ and conclude that third parties: (i) can acquire new spectrum in the upcoming PSSR auction because BT/EE does not have the ability to bid strategically;⁷⁰ and (ii) have a range of alternative strategies to acquiring spectrum,⁷¹ including relying on existing spectrum holdings⁷² to maintain competitive data packages and speeds and therefore to compete effectively with the merged entity.

BT/EE can foreclose deployment of small cells in the short to medium term by winning only 20-40 MHz in the 2.3 GHz band in the PSSR auction

3.10 Repeating Ofcom's analysis, the Provisional Findings reason that the cost of strategic bidding in the PSSR auction is likely to be high, and therefore unlikely, because: (i) the merged entity must acquire the entirety of the spectrum being auctioned for the strategy to be effective; and (ii) the high volume of spectrum on sale (190 MHz) will push the price of spectrum well above the intrinsic value of the spectrum for the merged entity.⁷³

3.11 This reasoning is flawed because the merged entity need only acquire the readily usable high frequency spectrum available in the PSSR auction, i.e. the 40 MHz in the 2.3 GHz band being auctioned, in order successfully to frustrate rivals' ability to deploy small cells in the short to medium term.

3.12 In fact, acquiring only 20 MHz may be a successful strategy because it would limit the number of rivals, ✂, able to acquire spectrum for a small cell deployment. 20 MHz in the 2.3 GHz band is likely to be the minimum necessary to deploy a small cell network in the short to medium term; any less would be insufficient for the roll out of a small cell network that supports competitive offerings of high data speeds and volumes.⁷⁴ As there is only 40

⁶⁶ Paragraphs 58 -62, G16-G18, Appendices.

⁶⁷ Capacity needs in terms of data volumes and speed grow 57% year on year, and are expected to continue to grow in the same rate, see Cisco, Global - 2019 Forecast Highlights, http://www.cisco.com/assets/sol/sp/vni/forecast_highlights_mobile/index.html. Macro upgrades alone are unlikely to satisfy data growth.

⁶⁸ Paragraphs 5, 6.7-6.10, 6.20(a) Provisional Findings; paragraph 28(b), E6-E7, Appendices.

⁶⁹ Paragraphs 12.10, 12.27 Provisional Findings.

⁷⁰ Paragraphs 12.38 and 12.53(b) Provisional Findings.

⁷¹ Paragraphs 12.38, 12.49, 12.53(d) Provisional Findings.

⁷² Paragraph 39(a) to (c), G12, Appendices.

⁷³ Paragraphs 12.29-12.40 Provisional Findings; paragraphs 88-91, G24-G25, Appendices.

⁷⁴ Paragraphs 30 and 3.31, Ofcom, Statement, Public Sector Spectrum Release (PSSR), Competition and auction design issues for the 2.3 and 3.4 GHz spectrum award, including reserve prices, 26 October 2015, <http://stakeholders.ofcom.org.uk/binaries/consultations/2.3-3.4-ghz-auction-design/statement/pssr-statement.pdf>.

MHZ available, were the merged entity to win half of it, this could lead to only two operators holding readily usable spectrum for the deployment of small cells in the short to medium term.⁷⁵

- 3.13 Finally, Sky notes that the Provisional Findings inappropriately rely on Ofcom's decision not to impose a spectrum cap in the PSSR auction as evidence that the Merger will not give rise to a SLC as a result of the merged entity winning additional readily usable high frequency spectrum in the PSSR auction.⁷⁶ Ofcom, however, did not take the Merger into account in its decision, expressly deferring the analysis of the impact of asymmetric spectrum holdings in the context of the Merger to the relevant competition authority.⁷⁷

Insufficient evidence of effective counter strategies for MNOs to increase capacity, coverage and speeds

- 3.14 The Provisional Findings conclude that MNOs have a range of options to increase capacity and speeds relying on their existing spectrum holdings.⁷⁸ The Provisional Findings also implicitly conclude that MNOs do not need to rely on acquiring spectrum in the PSSR auction to increase network capacity in the macro layer and/or to deploy small cells in the short to medium term. Therefore the payoff of strategic bidding by the merged entity is considered uncertain.⁷⁹

- 3.15 The counter strategies considered in the Provisional Findings are: (i) utilising unused spectrum in the 800 MHz and 2.6 GHz bands; (ii) re-farming 3G spectrum; and (iii) cell sectorisation. In relation to each of these options, the evidence relied upon in the Provisional Findings either does not appear to support the conclusions drawn or it is not comprehensive enough and further analysis is required.

3.15.1 Any unused spectrum in the 800 MHz band will be used at the macro sites as it is not suitable for small cells. Only BT-EE and Vodafone have 2.6 GHz spectrum; O2 and H3G do not. Even if Vodafone has available 2.6 GHz spectrum to roll out small cells, post-merger the usage of 2.6 GHz spectrum will be confined to just one out of three competitors of BT/EE. Absent the merger, there would have been three operators with the ability to roll out small cells.

3.15.2 The evidence relied on in the Provisional Findings does not appear to support the finding that refarming is an efficient counter strategy. The Provisional Findings conclude that a substantial portion of 3G devices is likely to remain in use for a significant duration. The MNOs therefore are likely to use their spectrum to maintain their 3G network rather than refarm it to 4G on macro or small cells in the short to medium term (or beyond). Secondly, it is uncertain how quickly MNOs refarm their spectrum to 4G. The cost of refarming can be considerable. It will increase the MNOs' cost base and therefore affect the timing of refarming.⁸⁰ Further, the CMA should consider whether any refarmed spectrum is likely to be used for small cells or would be exhausted at the macro sites.

75

✂

76

Paragraph 12.37 Provisional Findings.

77

Paragraphs 30 and 3.31, Ofcom, Statement, Public Sector Spectrum Release (PSSR), Competition and auction design issues for the 2.3 and 3.4 GHz spectrum award, including reserve prices, 26 October 2015, <http://stakeholders.ofcom.org.uk/binaries/consultations/2.3-3.4-ghz-auction-design/statement/pssr-statement.pdf>.

78

Paragraphs 12.38, 12.49, 12.53(d) Provisional Findings; Paragraph 39(a) to (c), G12, Appendices.

79

Paragraph 12.38 Provisional Findings.

80

See for example Ofcom's analysis on the liberalisation of 900 MHz and 1800 MHz spectrum, which included estimates of significant costs of refarming these bands. Paragraphs 4.61 to 4.87, Ofcom, Application of spectrum liberalisation and trading to the mobile sector, a further consultation, 13 February 2009, <http://stakeholders.ofcom.org.uk/binaries/consultations/spectrumlib/summary/spectrumlib.pdf>.

- 3.15.3 Finally, the Provisional Findings do not discuss the merits of cell sectorisation other than to say that this is an option available to the MNOs to increase capacity.⁸¹ Further analysis is required to conclude that cell sectorisation can effectively increase capacity at the macro layer.
- 3.16 The evidence relied upon in the Provisional Findings does not support the conclusion that the MNOs have a range of options to increase capacity and speeds relying on their existing spectrum holdings. The CMA should revisit its analysis and consider further evidence.
- 3.17 In the following section, we turn to the assessment of wholesale input foreclosure in relation to access to suitable sites to deploy small cells and backhaul set out in Chapter 16 of the Provisional Findings.

3(C) Availability of sites for small cell deployment

- 3.18 In addition to high frequency spectrum, the deployment of small cells requires access to suitable locations for installation. The Provisional Findings conclude that access to appropriate sites is not a substantial barrier to the deployment of small cells by other operators.⁸²
- 3.19 It is, however, not clear that other operators can obtain access to the relevant sites and Openreach assets on an EOI basis as submitted by Ofcom and relied upon by the CMA.⁸³
- 3.20 Openreach does not currently provide access to its poles for small cell deployment, despite using these assets itself in its mobile infill infrastructure solution (“MiiS”) product.⁸⁴ Further, Openreach does not need to make access to these sites available on EOI basis just because it uses access to these sites as an input to one of its products. Nor does Openreach need to provide access to its exchanges for providers to rent space, whether generally or specifically for small cell deployment. Access to exchanges is provided only as an ancillary facility supporting the provision of a regulated product. Finally, Openreach neither provides access to street cabinets for any use nor has any obligation to do so.
- 3.21 The lack of access to Openreach sites is all the more concerning given the lack of suitable alternative sites.⁸⁵ The Provisional Findings rely on the availability of alternative sites for small cell deployment in reaching the conclusion that it is unlikely that the merged entity would be able to pursue a foreclosure strategy that would prevent other MNOs from also deploying small cells.⁸⁶ Sky notes, however, that these sites are either not suitable for small cell deployment, or are inferior to the Openreach sites which comprise an extensive existing national network of outdoor locations, readily powered and with existing fibre backhaul links.
- 3.22 Absent a change to existing regulation, access to the sites required for small cell deployment in the manner suggested in the Provisional Findings is not currently possible.

3(D) Availability of backhaul for small cell deployment

⁸¹ Paragraph 57 (a) and (b), G16, Appendix.

⁸² Paragraph 11.56, Provisional Findings.

⁸³ Paragraph 11.54, Provisional Findings.

⁸⁴ The EOI obligation applies only when downstream divisions consume Openreach products and not when Openreach self-supplies these inputs.

⁸⁵ See Annex 2.

⁸⁶ Paragraph 16.64, Provisional Findings.

- 3.23 The Provisional Findings do not consider the availability of backhaul for small cells as a standalone product.⁸⁷ This leads to a failure to identify the specific challenges arising for operators seeking suitable, fit-for-purpose backhaul to support small cell roll out post-merger.
- 3.24 Absent regulatory intervention, Openreach has chosen not to provide a standalone backhaul product that would deliver connectivity at third party sites hosting small cells. Instead, fibre backhaul is part of a bundle of products included in Openreach's MiiS product.
- 3.25 It is improbable that Openreach will choose, of its own volition, to offer unbundled access to fibre backhaul to support small cell deployments. This would favour third parties in deploying competing small cell networks. Evidence of BT's past behaviour in the roll-out of its superfast fibre network⁸⁸ and experience in respect of SoRs⁸⁹ also suggests that Openreach is unlikely to offer unbundled access to fibre backhaul.
- 3.26 Furthermore, whilst Ofcom's dark fibre proposals may prove suitable to provide backhaul connectivity to small cell locations, these proposals are still under consultation and there is no certainty that they will be implemented. Even if they are, there is considerable uncertainty as to their likely effectiveness, as there are no details of the dark fibre product design and in its present form, it is likely to prove expensive for short distance links like those that will be required to provide fibre backhaul to small cell sites.⁹⁰ Small cells are likely to be best served by backhaul in the form of a GEA variant that is currently not available.⁹¹

3(E) Impact on prices and quality in the short to medium term

- 3.27 Contrary to the provisional finding that it will take time⁹² for rivals to be harmed to such an extent that the merged entity would be able to increase its prices or worsen its services, the merged entity can foreclose competition in the deployment of small cells and as a result weaken competition in retail mobile markets in the short to medium term.
- 3.28 In terms of quality, the merged entity and Vodafone⁹³ are likely to be the only operators that can in practice deliver peak speed to several hundred Mbit/s. The merged entity's existing high frequency spectrum holding and its ability to bid strategically in the PSSR auction create the potential for a scenario where only the merged entity and Vodafone have readily usable high frequency spectrum for small cells that increase capacity to support retail mobile broadband services of several hundred Mbit/s. Since neither H3G or

⁸⁷ Had the Provisional Findings done so, it would also have been necessary to consider the extent to which BT-EE would be able to degrade the quality of those backhaul inputs post-Merger. The approach taken in the Provisional Findings to mobile backhaul inputs (i.e. based on an assessment of evidence of previous occasions when BT may have circumvented existing regulation in the market) is, however, incorrect as it ignores the interplay between incentive and ability. It is not possible to draw conclusions on BT-EE's ability to degrade service quality post-merger on the basis of BT's conduct pre-merger, where BT had no incentive to degrade quality vis-à-vis the MNOs. The same holds true for the assessment of quality of backhaul inputs for small cells.

⁸⁸ Openreach rolled out BT Group's superfast broadband network and did not make available unbundled access to the inputs of the GEA product that would allow its fixed competitors to roll out competing superfast broadband networks despite SoR requests like Sky's SoR for an unbundled FTTC product.

⁸⁹ Internally driven SORs (i.e. submitted by BT Group) are more likely to be implemented and implemented more quickly than external SORs. See Annex 3.

⁹⁰ Ofcom proposes to benchmark the price of dark fibre to the price of 1G EAD. The price of 1G EAD is too high for short distance links like those that will be required for fibre backhaul to small cell sites. The proposed one off price reductions to 1G EAD do not drastically change the attractiveness of dark fibre for short distance links.

⁹¹ Paragraph 20, summary of hearing with Telefonica on 28 July 2015.

⁹² Paragraph 12.9 Provisional Findings.

⁹³ If Vodafone acquires spectrum in the 2.3 GHz band in the PSSR auction.

O2 have high frequency spectrum (and may not be able to acquire any in the PSSR auction), competition in the segment of very high speed mobile connections will be reduced and will be weaker than competition in currently used frequencies.⁹⁴ With current spectrum assignments, competition for high speed mobile connections is for most handset types limited to just two out of the four operators (Vodafone and BT/EE), while in the absence of the Merger, Vodafone, BT and EE would have had the ability to offer such services.

- 3.29 Even if rivals are able to acquire additional spectrum in the PSSR auction, the use of that spectrum, in particular at 3.4 GHz, is limited due to the lack of handset availability. As a result rivals would not be able to provide high speed services to a sufficiently sizeable proportion of their customer base in the short to medium term. Many more devices work at the merging parties' 2.6 GHz FDD frequencies than at 2.3 GHz or 3.4 GHz. This is reflected in anticipated valuations for the different spectrum bands. Ofcom has set a reserve price of just £1m for 5 MHz of 3.4 GHz spectrum in contrast to a total investment by BT of £201m in 2x15 MHz of 2.6 GHz FDD spectrum and 25 MHz of 2.6 GHz TDD spectrum. The low reserve price for 3.4 GHz reflects its lower value, in turn reflecting its more limited use. Acquisition of this spectrum by third parties would represent a poor counter strategy and a weak competitive constraint on the merging parties. The Provisional Findings fail to take due these considerations into account thereby overestimating the effectiveness of such counter strategies.
- 3.30 Second, if only the merged entity and Vodafone are able to build small cells, their average costs for serving higher speed customers in general (not just the segment of consumers interested in extremely high speeds), is likely to be significantly lower than that of H3G/O2, while the average cost of serving less speed conscious customers remains similar for all operators. Cost asymmetries can result in a quality segmentation in the market where Vodafone and the merged entity concentrate on higher speed customers and H3G/O2 and other rivals on less speed conscious customers, artificially segmenting the market, thereby weakening competition overall and increasing prices.
- 3.31 In addition to the negative effects on competition of creating a market segment in which only two MNOs are able to compete and of incentivising MNOs to segment the market by quality, asymmetries in small cell deployment will also lead to cost asymmetries in the provision of mobile data. Such cost asymmetries will arise since competing MNOs need to rely on (imperfect) spectrum substitution strategies due to the fact that high frequency spectrum is allocated highly asymmetrically. The negative effects due to cost asymmetries have, under standard models of competition, the following consequences:
- 3.31.1 As long as MNOs offer a range of products that are broadly comparable (i.e. product differentiation is not too strong), then average prices increase as costs become more asymmetric.
- 3.31.2 BT/EE's higher spectrum allocation increases the pivotal position of BT/EE in the market in the sense that it is less likely that other operators would have the capacity to serve all users without BT/EE. Such a strengthening of its pivotal position also leads to higher average prices.
- 3.31.3 The larger capacity available to BT/EE relative to its competitors will increase BT/EE's relative profitability and is likely to lead to a persistent advantage.
- 3.32 Foreclosure in the deployment of small cells is likely to result in worsening quality and/or increasing prices for consumers. The CMA should consider further the impact the merger

⁹⁴

An example of small cell deployment supporting high speed mobile broadband services is by Optus in Australia. See <https://media.optus.com.au/media-releases/2015/case-study-optus-evolves-its-network-of-the-future-advances-4g-with-480-mbps-peak-speeds-and-tests-4x4-mimo/>.

is likely to have on the deployment of small cells and ultimately on retail competition in mobile services.

4. Treatment of existing regulation in wholesale superfast broadband

- 4.1 Finally, notwithstanding the conclusion in the Provisional Findings that the Merger gives rise to effects in the provision of wholesale superfast broadband services that require adaptation of existing regulation, responsibility for addressing this is deferred entirely to Ofcom. The Provisional Findings do not signal in any way what specific adaptations would be required or within what timeframe, nor consequently is there any assessment of why the CMA is confident that such adaptations would remedy the identified adverse effects.
- 4.2 It is important for the CMA, in reaching its final conclusions as part of the Merger review, to set out its view on the specific adaptations and guidance required, including relevant timeframes for implementation. At the very least, the overarching principles governing the adapted implementation of the VULA margin condition should be decided prior to the CMA issuing its final report.
- 4.3 Sky agrees with the Provisional Findings regarding BT's significant market power in the provision of wholesale superfast broadband inputs, BT's strong incentives to foreclose downstream competitors in superfast broadband and the merger specific effects in relation to the provision of wholesale superfast broadband inputs.
- 4.4 Absent effective regulation, as acknowledged in the Provisional Findings, the impact of foreclosure on retail superfast broadband competition could be significant. The next two years are critical in the development of retail superfast broadband competition, with take-up forecast to grow significantly.⁹⁵ In light of the impact of the Merger in increasing the complexity of the operation of the VULA margin condition, undue delays in adapting the test to address the effects of the Merger could undermine retail competition.
- 4.5 Sky supports the provisional finding that the Merger increases the complexity in operating the VULA margin condition and that the implementation of the condition requires adaptation. It is therefore important for the CMA to:
- 4.5.1 set out its views on the overarching principles governing the operation of the VULA margin condition by the time of publication of its final report; and
- 4.5.2 specify the timeframe for the introduction of revised guidance relating to the VULA margin condition by the time of completion of the Merger, taking into account the need for due consultation by Ofcom prior to publication of the guidance.
- 4.6 These steps are necessary to ensure legal certainty for CPs at a time when, as noted in paragraph [4.3] above, fibre broadband is becoming increasingly important to CPs' ability to effectively compete. Ofcom itself recognised the importance of this in its VULA margin final statement:

"[w]hile there are currently several large competing operators to BT in the provision of broadband services, a degree of regulatory and market certainty is necessary to facilitate their ongoing investment, in particular in relation to providing superfast broadband (which is still a developing consumer proposition). Therefore if BT can undermine this such that the ability and incentive of these operators to invest in winning superfast broadband subscribers and to offer competitive retail propositions is reduced, it may be able to build a large share of retail superfast broadband

⁹⁵

Analysys Mason forecasts 15 million superfast broadband lines by 2017 – Analysys Mason, *Fixed voice and broadband in Europe: forecasts 2013-018*, 10 February 2014.

*subscribers in the longer run⁹⁶... by engaging in this behaviour BT could potentially build a strong retail market position which could endure into the long term, weakening the competitive constraint it faces from other CPs in the future...*⁹⁷

- 4.7 There are two possible overarching approaches to adapting the VULA margin condition to take account of the addition of mobile services: using either (i) MVNO wholesale rates (as was contemplated by Ofcom pre-merger); or (ii) the relevant costs of a MNO. Ofcom noted that the purpose of the VULA margin condition was to ensure that:

*"BT does not set the VULA margin such that it prevents an operator with slightly higher costs than BT (or some other slight commercial drawback relative to BT) from being able to profitably match BT's retail superfast broadband offers."*⁹⁸

- 4.8 Ofcom considers Sky and TalkTalk to be appropriate comparators as they are the "largest retail rivals to BT"⁹⁹ of the non-BT CPs who purchase VULA.
- 4.9 In its final report, it is therefore important that the CMA reflects this approach and signals its preference for the VULA margin condition to consider an Equally Efficient Operator facing MVNO relevant costs. This would most closely approximate the costs of Sky and TalkTalk who are dependent on wholesale MVNO arrangements and therefore be the most relevant parameter against which to assess margin squeeze.

5. Conclusions and next steps

- 5.1 For the reasons set out above and in Annex 1, there is sufficient evidence that SLCs are likely to arise in wholesale mobile services and in respect of small cell deployments, ultimately leading to a significant loss of competition, including the stifling of emerging competition and technologies in retail mobile. Adverse effects from the Merger in relation to retail superfast broadband competition will also allow BT to strengthen further its already strong position adding to the risk of re-monopolisation in fixed broadband services. Together, these adverse effects would, left unchecked, have far-reaching consequences for wholesale customers and consumers in the UK communications sector.
- 5.2 In order to fully discharge its statutory duties, the CMA should:
- 5.2.1 perform a full assessment of partial foreclosure risks in wholesale mobile services and revisit its assessment of total foreclosure risks to correct the errors identified above and consider the totality of evidence provided;
- 5.2.2 perform a coherent assessment of the risks of a SLC arising in relation to small cell deployment on its own terms;
- 5.2.3 consult on appropriate remedies to address the above SLCs; and

⁹⁶ See paragraph 3.65 of Ofcom's VULA margin final statement, http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/statement/VULA_margin_final_statement.pdf

⁹⁷ See paragraph 3.67 of Ofcom's VULA margin final statement, http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/statement/VULA_margin_final_statement.pdf

⁹⁸ See paragraph 1.8 of Ofcom's VULA margin final statement, http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/statement/VULA_margin_final_statement.pdf

⁹⁹ See paragraph 6.452 of Ofcom's VULA margin final statement. Ofcom repeatedly refers to data from Sky and TalkTalk at other junctures, see for example paragraphs 6.151, 6.158, 6.166, 6.202, 6.454 and 7.106 of Ofcom's VULA margin statement http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/statement/VULA_margin_final_statement.pdf

- 5.2.4 ensure that swift and specified action is taken to address the merger effects in relation to wholesale superfast broadband inputs.

Sky 20 November 2015

ANNEX 1

CRA Paper

BT-EE Comments on the CMA's Provisional Findings on wholesale mobile services

ANNEX 2

Suitability of sites for small cell deployment

The 400,000 sites Virgin and Arqiva have access to are clustered in few urban locations. Sky considers therefore that these are not locations that are suitable for a nationwide small cell roll out at scale and so should not weigh heavily in the assessment of whether other rivals have the ability to replicate the merged entity's small cell network.

Bus shelters, billboards and street furniture from private suppliers or councils for street furniture, as well as locations of national retail chains or the Transport for London are inferior locations to those in the merged entity's estate and do not afford rivals the same ability to roll out small cells at scale, quickly and economically. The problem with these locations is that they require rivals to negotiate with multiple landlords while the merged entity needs only to choose a location from its own estate and proceed with building. Multiple landlords add administrative overheads and delay in the process for the rivals which the merged entity does not face. The price of access is also likely to be higher than the Openreach incremental cost borne by the merged entity. Finally and importantly these locations are unlikely to have fibre backhaul serving or near the premises ready to be switched on like the locations in the merged entity's estate. All these characteristics cumulatively make these locations less suitable for a small cell roll out and question whether rivals can replicate the ability of the merged entity to roll out small cells at scale in the short to medium term.

ANNEX 3

SoR Process

BT divisions' plans and aspirations are therefore brought to market more quickly and more effectively than those of competing CPs as BT divisions are able to get the developments they need through the SoR process more quickly and more often. In concluding, however, that there isn't "any evidence of BT using the SoR process to discriminate against its current rivals (which suggests that BT does not have the ability to do so)", the Provisional Findings rely unduly on submissions by the merging parties indicating that there is no overt discrimination without placing sufficient (if any) weight on the evidence submitted by third parties that there is a strong tendency by BT to favour its downstream divisions, as can be seen in the non-equivalent outcomes arising from the SoR process.. The Provisional Findings appear to ignore Ofcom's acknowledgement that regulation cannot remove BT's strong incentives to favour its downstream division, and can only partly control BT's current ability to foreclose downstream rivals (Section 11 of Ofcom's Strategic Review of Digital Communications, Discussion document dated 16 July 2015 <http://stakeholders.ofcom.org.uk/consultations/dcr-discussion/>). This misguided conclusion subsequently infects the analysis in the Provisional Findings regarding the merged entity's ability to discriminate against downstream competitors in both mobile backhaul and small cell deployment, analysis which ultimately contributes to the conclusion that there is no SLC.

SoR submitted by	Number of SoRs submitted	SoRs delivered / in development	% of SoRs delivered / in development that were delivered within 1 year	% of SoRs delivered / in development that were delivered within 2 years
BT Group	169	87 (51%)	40%	75%
Non-BT Group	145	35 (24%)	34%	69%