

CASE ME/7064/23
Vodafone / CK Hutchison JV merger inquiry

[X] observations on the Parties' response to CMA's Notice of possible remedies

1. INTRODUCTION AND EXECUTIVE SUMMARY

- 1.1 This paper sets out the observations from [X] on the response dated 30 September 2024 (the "**Parties' Remedies Response**") made by Vodafone Group plc (together with all companies forming part of the same group, "**Vodafone**") and CK Hutchison Holdings Limited (together with all companies forming part of the same group, "**Three**" and together with Vodafone the "**Parties**") to the CMA's notice of possible remedies dated 13 September 2024 (the "**Remedies Notice**") in relation to the anticipated joint venture between the Parties (the "**Proposed JV**"). The Remedies Notice followed the CMA's Provisional Findings Report dated 13 September 2024 in relation to the Proposed JV (the "**Provisional Findings**").
- 1.2 [X]
- 1.3 [X] has made a number of submissions in order to assist the CMA in its assessment of the Proposed JV, including but not limited to:
- 1.3.1 A response dated 19 July 2024 to the initial submissions made by the Parties on the CMA's decision to refer the Proposed JV under section 33 of the Enterprise Act 2002 ("**19 July Submission**");
- 1.3.2 A submission prepared by [X] dated 16 August 2024 analysing the [X] as a result of the Proposed JV (the "**[X] Foreclosure Submission**");
- 1.3.3 A submission dated 27 September 2024 setting out [X] views on the Remedies Notice (the "**[X] Remedies Submission**"); and
- 1.3.4 A submission prepared by [X] dated 3 October 2024 analysing in further detail why a reserved capacity remedy would restore competition in the wholesale market (the "**[X] Capacity Submission**").
- 1.4 [X] agrees with the CMA's provisional conclusion that the Proposed JV will result in a substantial lessening of competition ("**SLC**") in both the supply of retail mobile telecommunications services to end customers (the "**retail market**") and the supply of wholesale mobile telecommunications services (the "**wholesale market**").
- 1.5 As further set out below, [X] strongly disagrees with the Parties' view on possible remedies as set out in the Parties' Remedies Response. In particular, and contrary to the Parties' position, the Proposed JV will result in SLCs both at the wholesale and retail market through the removal of a key MNO in the UK market, and a remedy centred around a pre-agreed wholesale access offer will soften competition and lead to the ossification of competition between MVNOs within the UK retail mobile telecommunications market. A capacity and divestment remedy need not, as the Parties claim, lead to network inefficiencies and has the benefit of being capable of immediate implementation.
- 1.6 Although [X] does not accept it to be the case, however, if the Parties are correct and a capacity ring-fencing remedy is unworkable or ineffective at addressing the SLCs, the only solution will be for the CMA to prohibit the Proposed JV in order to address the SLCs in the Provisional Findings.

2. THE PROPOSED JV REMOVES A KEY POTENTIAL PROVIDER OF WHOLESALE ACCESS FOR MVNOs

- 2.1 The Proposed JV would substantially lessen [X] ability to secure a competitive wholesale access agreement with an MNO, materially undermining its ability to continue to provide competitive retail propositions.
- 2.2 In considering the extent of the SLC, and hence the extent to which a remedy may restore competition, the CMA must take into account the fact that absent the Proposed JV, [X].
- 2.3 [X].
- 2.4 As noted in the 19 July Submission, [X], which is well-known to the incumbent MNO provider. This is illustrated by the fact that [X].
- 2.5 [X]. It is for this reason that [X].
- 2.6 However, the benefit of [X], risks being undermined in its entirety by the removal from the market of Three - a key [X] provider of the relevant service (in this case, wholesale telecommunications services access). As previously communicated to the CMA,¹ [X] views Three as a strong competitor for the wholesale supply to MVNOs – in particular, [X] Three tends to price aggressively often offering the lowest price MVNOs and brands on its network. The only reason provided by [X].
- 2.7 Absent the Proposed JV, [X] in negotiating a highly competitive deal. The remedies imposed by the CMA in relation to the Proposed JV need to replicate (for remedies short of prohibition) or reinstate (in the case of a prohibition) the same level of competitive tension for MVNOs, including [X], when tendering for wholesale access contracts, as would continue to exist in the counterfactual.

3. COMMENT ON RETAIL LEVEL SLC

- 3.1 While this response focusses on the remedies proposed to address the wholesale SLC identified by the CMA, [X] would make the following two observations with regards to the retail SLC:
- 3.1.1 The proposed "*SMARTY Pricing Commitment*"² operates by reference only to the SMARTY brand, rather than all of the Parties' fighting brands, and as such is insufficient to police against retail price increases caused by the Proposed JV. Further, the commitment is short-term in nature and liable to give rise to distortive effects, not least because the MVNOs compete in particular at the 5GB data level, which under the Parties' proposal will likely continue to see retail price increases for non-SMARTY customers and therefore that segment in general; and
- 3.1.2 As previously communicated to the CMA, any remedy to address the retail SLC should include a requirement that the Parties divest all their fighting brands. The Parties' Remedies Response does not contain such an obligation, and therefore fails to adequately address the retail SLC.

¹ See section 2 of the 19 July Submission.

² Parties' Remedies Response, paragraphs 5.11 to 5.16.

4. **A PRE-AGREED WHOLESALE ACCESS OFFER WILL NOT ADDRESS THE SLCs AND WILL GIVE RISE TO SIGNIFICANT DISTORTIONS**

4.1 As communicated to the CMA on the remedies call on 1 October 2024, [X] wants competition in the telecommunications services market in the UK to be as unfettered as possible. In particular, [X] strongly believes that competition will only work well, in the best interests of consumers, if it supports and enables the most efficient providers in the marketplace.

4.2 A pre-agreed wholesale access offer remedy does the precise opposite of this, and replaces competition on the merits with regulation. This, in turn, will lead to an ossification of the market and the removal of dynamic competition between MVNOs. Simply put a wholesale access offer remedy will significantly soften the level of competition between MVNOs within each of the parameters included by the Parties in the pre-agreed wholesale access offer. The Parties' Remedies proposes:

4.2.1 Three prescribed tiers of pricing based on prevailing market rates at the outset

4.2.2 Indexation linked to the Parties' own average revenue per user;

4.2.3 Maximum duration of MVNO contracts of five years;

4.2.4 Prescriptive terms around implementation costs;

4.2.5 Minimum revenue commitments, pursuant to which MVNOs will be required to commit to minimum revenue levels and obliged to make up any shortfall in the same; and

4.2.6 Payment terms, determined (seemingly by the Proposed JV) according to the perceived degree of risk posed by the MVNO.

4.3 As noted in the [X] Remedies Submission, the above terms (in particular price, indexation, minimum revenue commitments and payment terms) are among the most important features considered by MVNOs when negotiating access to wholesale mobile services. As such, the remedy proposed in the Parties' Remedies Response risks effectively "fixing" a significant part of the costs and underlying terms, and therefore competition between MVNOs. This would run counter to a number of observations made by the CMA in its *CMA Merger remedies Guidance* (CMA87) (December 2018) in relation to the significantly distortive capacity of remedies, such as the one proposed by the Parties, which seek to control market outcomes.³

4.4 In addition and as noted in the [X] Remedies Submission, the above difficulties are exacerbated in the context of a constantly evolving dynamic market. It would not be sufficient simply to set the terms of wholesale access for a significant period, as offers that may be competitive today may quickly become uncompetitive over time. Contrary to the Parties' views, the need for MVNO agreements to keep pace with the constantly evolving market in the UK telecommunications services market is not addressed simply by including a mechanism for future pricing adjustments (although such mechanisms are important) – rather, it can only be achieved through enabling MVNOs to negotiate freely with the Proposed JV, against the backdrop of reserved capacity, certain minimum commitments on the Proposed JV and robust termination rights for the MVNO (to ensure that there is no risk of the MVNO being constrained to continue with a contract that may restrict its ability to compete over time). Furthermore, given Vodafone's recent record of increasing retail prices ([X] believes by a total of c.33% over the last three years), it appears a foregone conclusion that the Parties' proposals, if adopted,

³ See, for example, the discussion at paragraphs 4.2 and 4.3 of the [X] Remedies Submission.

would significantly increase wholesale costs to MVNOs once the suggested two year price freeze ends, with a knock-on effect on retail prices, harming *inter alia* the UK's price-conscious consumers least able to afford them.

4.5 Another related and fundamental concern with a pre-agreed wholesale access offer remedy is that it enables the Parties to enter into superficially competitive agreements which leave multiple levers for the Parties to worsen the commercial realities of the arrangement. Such levers can exist on two different levels:

4.5.1 **Design of the offer:** the way in which a pre-agreed wholesale access offer is designed, and terms which are included, will have a direct impact on both the ability of MVNOs to avail themselves of the benefits of the remedy as well as the Parties' ability to foreclose such MVNOs.⁴ Examples of this include:

Eligibility criteria: [REDACTED].

[REDACTED].

[REDACTED].

Future pricing mechanism: The Parties' Remedies Response includes a future pricing mechanism, which the Parties claim will act to "*protect the MVNOs and account for the likely future evolution of retail pricing and customer data usage in the market*".⁵ While the precise mechanics of the pricing adjustment mechanism suggested by the Parties have been redacted from the public version of the Parties' Remedies Response, it appears to be based entirely on elements of the Parties' own retail operations (e.g. average revenue per user of the Proposed JV and average monthly data usage of the Proposed JV).

As noted in the [REDACTED] Remedies Submission, it is essential that any pricing indexation or adjustment mechanism is properly designed and calibrated to take account of "*retail pricing and efficiency developments in the particular market / segment targeted by the particular MVNO's proposition(s)*".⁶ By tying the pricing adjustment mechanism in the Parties' Remedies Response exclusively to the Proposed JV's own activities, the potential benefits and pricing protections afforded to the MVNO is almost entirely within the gift of the Proposed JV itself (subject to any competitive constraint from the other MNOs etc.). This issue will be particularly stark if, as [REDACTED] anticipates, the Proposed JV shuts down one or more of the Parties' own retail fighting brands (Voxi, Talkmobile and Smarty) as this would almost certainly lead to a significant increase in the Proposed JV's average revenue per user (thereby severely undermining the protection from the future pricing mechanism).

Minimum revenue guarantee: the Parties' Remedies Response also makes clear that a minimum revenue commitment will form part of the pre-agreed wholesale access offer. [REDACTED]. In particular, the ostensible relief to MVNOs from a downward indexation which [REDACTED] views as vital, risks being undermined entirely by the lower aggregate revenues generated by the MVNO (due to offering a lower price to customers in order to remain in lockstep with market developments and competition) triggering a minimum revenue payment obligation and leaving the

⁴ For a detailed discussion of the [REDACTED], and other MVNOs like it, please refer to the [REDACTED] Foreclosure Submission.

⁵ Parties' Remedies Response, paragraphs 6.30 to 6.31.

⁶ [REDACTED] Remedies Submission, paragraph 4.6.2 (emphasis added).

MVNO facing potentially significant losses or having to make further, likely deeply unattractive, concessions to the host MNO.

Balancing an indexation mechanism with a minimum revenue guarantee is difficult in the context of an actual commercial negotiation between two identified and experienced parties – [X] cannot see how one could design *ex ante* and then apply it wholesale to all qualifying MVNO arrangements, without giving rise to significant distortion risks. [X].

4.5.2 **Operation of the agreement:** the Parties will also be able to use their increased market power, both at the wholesale and retail levels, to worsen the commercial terms of an MVNO agreement *in practice* even if the terms are, at face-value, competitive. For example, as noted in [X] observations submitted 4 October 2024 on the Provisional Findings, [X].

4.6 As such, [X] strong belief remains that the Parties' proposal of a pre-agreed wholesale access offer will not address the SLCs identified by the CMA, will be unworkable and will leave the MVNOs exposed to anti-competitive and/or discriminatory measures⁷ from the Parties.

5. THE ONLY SOLUTION SHORT OF PROHIBITION IS A CAPACITY REMEDY SUPPORTED BY ADDITIONAL BACKSTOPS

5.1 The Parties object to a capacity ring-fencing remedy on the following grounds:

5.1.1 It is not necessary;

5.1.2 It would lead to inefficient use of capacity and reduce the efficiencies that may result from the Proposed JV; and

5.1.3 It would not be capable of implementation for technical and practical reasons until at least three years after completion.

5.2 Each of the Parties' objections is misconceived.

The capacity ring-fencing remedy is not necessary

5.3 As set out in detail in the [X] Remedies Submission, [X] preferred option for addressing the wholesale SLC is to impose an obligation on the Parties to ring-fence a sufficient proportion of the Proposed JV's network capacity exclusively for MVNOs without setting pre-agreed access terms for that capacity. This remedy would have the following two important characteristics: (1) the reserved capacity would be set at a level equal to the current total capacity dedicated by the Parties to MVNOs, but with sufficient headroom to also enable dynamic competition and to account for either the Parties shutting down some of their retail brands, or a potential CMA

⁷ For completeness and in relation to the Parties' claim that the Proposed JV will lead to significant improvements in network quality, the Proposed JV will be incentivised to discriminate against MVNOs and not offer the full speed / network improvements to rivals. Therefore, even *if* the Parties achieve some of their claimed benefits (which is not guaranteed), the Proposed JV will be incentivised to ensure that such benefits only accrue to a portion of the market. The hypothetical improvements can therefore be used by the Proposed JV as a discriminatory tool. Relatedly, there is no way to sensibly police the investment remedy proposed by the Parties – in particular, if the Parties do not comply with their investment obligations, it will be exceedingly difficult to address such breaches after the fact and the negative effects of the SLC will not be addressed.

divestment order affecting the Parties' retail brands and (2) a financial penalty to incentivise the Proposed JV actually to sell the reserved capacity.⁸

- 5.4 A capacity ring-fencing remedy with these characteristics would enable one or more MVNOs to have access to a guaranteed pool of capacity of the Proposed JV but, importantly, each MVNO would remain responsible for negotiating its own terms of such wholesale access. This would ensure that competition between MVNOs on the Proposed JV's network can be maintained, and thereby minimise inadvertent market distortions created by the remedy.
- 5.5 In short, [X] views a capacity remedy as the only appropriate remedy (short of prohibition) to address the wholesale SLC.

The capacity ring-fencing remedy would lead to inefficiencies

- 5.6 The Parties have interpreted the scope of the proposed ring-fencing capacity remedy as requiring the Proposed JV to technically and/or physically segregate a proportion of its capacity for exclusive use by MVNOs.⁹ The Parties further allege that, even with attractive pricing, there is a risk that sufficient MVNOs will not move onto the Proposed JV's network and fill the ring-fenced capacity.
- 5.7 Further, the Parties contend that even assuming that all of the reserved capacity is used by MVNOs, the remedy will nevertheless lead to inefficiencies. In particular, the Parties argue that their pooled capacity under the Proposed JV would enable them to utilise the same capacity across their entire retail and MVNO base, which will enable them to better serve different demand patterns and busy hours. A ring-fencing remedy would, according to the Parties, prevent the Proposed JV from utilising spare capacity from one part of its network to alleviate congestion on another part of the network.
- 5.8 [X] strongly disagrees with the Parties' assertion that the ring-fenced capacity remedy would lead to inefficiencies. The Parties' concerns stem exclusively from taking an arbitrarily narrow approach to the capacity ring-fence remedy. In particular:

5.8.1 As a preliminary observation, it is unclear to [X] why the Parties appear to have assumed that the capacity ring-fencing remedy must, by its very nature, take the form of a physical and/or technical segregation of the MVNO capacity from the part of the network which is not ring-fenced. To the contrary, it is possible for the capacity ring-fencing remedy to be implemented in the form of a commercial reservation remedy. In particular, and as noted in the [X] Capacity Submission, capacity which is sold by the Proposed JV to MVNOs would by definition not be available to the Proposed JV, and this would remove the need to go through complex engineering solutions to split the Proposed JV's integrated capacity into two separate capacity pools.

5.8.2 Further, while it is technically correct to say (as the Parties do) that "*[a]ny spare capacity that [the Proposed JV] would be prevented from using would lead to inefficiencies*"¹⁰ this statement is so broad and universally applicable that it fails to convey any meaningful insight. By definition, any spare capacity of any kind which, at a particular moment in time, is not utilised is not being used effectively.

⁸ For completeness, and as set out in the [X] Remedies Submission, [X] also considers that any remedies package must include some additional minimum backstops to counter the Parties' [X] as well as an obligation to divest themselves of their retail fighting brands.

⁹ See Parties' Remedies Response, paragraph 7.9.

¹⁰ See Parties' Remedies Response, paragraph 7.10(ii).

Further, if the Parties' concern is instead that a capacity ring-fencing remedy would lead to any proportion of the reserved capacity being unused, that is misplaced and can be addressed:

- 5.8.2.1 As noted in the [X] Capacity Submission, the level of capacity needs to be pitched to accommodate (1) current MVNO usage of the Parties, (2) dynamic competition and potentially (3) headroom to enable MVNOs to restore competition in the event that Parties shut down their retail fighting brands (and the CMA rejects [X] suggestion that such brands should be divested). If pitched at this level, and combined with a penalty to incentive the Proposed JV to sell the capacity, there is little scope for the ring-fence capacity remedy to lead to material levels of MVNO capacity being unused;
 - 5.8.2.2 While [X] views as unfounded the Parties' concerns regarding potentially material capacity being unused as a result of the remedy, any residual concerns can be further addressed by enabling the monitoring trustee and/or Ofcom to adjust the level of capacity that is being commercially ring-fenced to MVNOs if material capacity has remained unused for a sufficiently long period of time despite the Proposed JV complying with its obligations under the remedy to sell such capacity; and
 - 5.8.2.3 More fundamentally, the commercial capacity reservation remedy (combined with a penalty) eliminates the risk of any spare capacity being unutilised. In equilibrium, all such reserved capacity will be sold, in line with the Parties' incentive under the penalty mechanism. However, if some of the reserved capacity is not sold for some reason, then the Parties have an incentive to instead use such capacity themselves. In particular, the penalty will get levied regardless of whether the Parties use the unsold capacity or not, so the best strategy for the Parties with regards to unsold capacity will be to use it themselves (at least until such time that the capacity can be sold to MVNOs).
- 5.8.3 In relation to the Parties' further assertion that a capacity ring-fence remedy would prevent the Proposed JV from utilising spare capacity from one part of its network in order to alleviate congestion on another part, this again stems from the Parties' assertion that any ring-fencing remedy would invariably need to take the form of a fully segregated network for the MVNO capacity.
- 5.8.4 As noted in the [X] Capacity Submission, under a commercial reservation remedy, the Parties can still pool their capacity and the Proposed JV's network can be run as a single unit and thereby protect any efficiency benefits. Further, this approach would remove any complexities around monitoring whether capacity reserved for MVNOs through technical solutions was actually reserved. It is much simpler to determine the proportion of total capacity the Proposed JV sold to MVNOs in a given period and check whether it met the minimum reservation thresholds.

The capacity ring-fencing remedy would not be capable of implementation until at least three years after completion of the Proposed JV

- 5.9 The Parties allege that from a technical standpoint, a capacity ring-fence remedy would not be capable of implementation until at least three years after completion of the Proposed JV.

However, the Parties offer little by way of reasoned explanation for why this is so (other than vague references to a requirement to have 5G standalone core and associated updates to its network).

- 5.10 There is nothing that would prevent a commercial reservation remedy to be implemented immediately. Further if the Parties cannot implement their proposed remedy involving a technical segregation of capacity until three years from completion, the remedy can take the form of a commercial reservation obligation until such time as the Proposed JV has had sufficient time to ensure that the remedy can be implemented in the manner which the Parties envisage.

As the above makes clear, the remedies proposed by the Parties clearly do not address the SLCs identified by the CMA in the Provisional Findings. [X] has proposed a remedy package which it believes will fully address the SLCs identified by the CMA and which is workable in practice. However, if the CMA has any residual concerns regarding the effectiveness and appropriateness of [X] proposed remedies package, the way to address such residual concerns has to be a prohibition of the Proposed JV. It cannot be to dilute or make the remedies package proposed by [X] less robust, or ossifying the market in endless regulatory disputes by relying on a pre-agreed wholesale access offer remedy. Nor should the CMA assume that the very real and wide-ranging SLCs will be outweighed by the highly speculative benefits proposed by the Parties (which would, in any event, at best accrue to a small number of consumers).