ANTICIPATED JOINT VENTURE BETWEEN VODAFONE GROUP PLC AND CK HUTCHISON HOLDINGS LIMITED CONCERNING VODAFONE LIMITED AND HUTCHISON 3G UK LIMITED

Response on Remedies Working Paper (RWP)

[redacted] is pleased to submit comments on the Remedies Working Paper of 5th November 2024.

Below we highlight our comments on the proposals for time limited protections in the retail and wholesale markets. We would be happy to elaborate on these points in a discussion with the CMA.

We agree with the CMA's provisional conclusion in 1.6 that a network commitment (with some time limited protections in the retail and wholesale markets) is a more proportionate remedy than prohibition of the Merger.

Time limited customer retail protections

Conceptually, we believe the best way to ensure consumers have choice and access to low prices is through competitive wholesale access terms rather than a Pricing Cap Commitment at the retail level. MVNOs in the UK market have been successful in providing consumers with wider choices that save them money, as evidenced by their growing share of the value market in the UK. We believe the CMA's remedy package must build on and support this trend.

In our view the Pricing Cap Commitment from the Merged Parties is too prescriptive and not fit for purpose. Taking a static subset of retail tariffs, and freezing prices for these over a multi-year period, will not be as effective as ensuing third party MVNOs have access to highly competitive wholesale access terms that allow them to compete profitably and sustainably in the retail market.

We note the Parties revised commitment that *"they are willing to maintain prices across their main brands (Vodafone, Three, Smarty and Voxi) for 36 months for all Vodafone and Three PAYM Simo tariffs, Voxi and Smarty tariffs under 20 GB monthly, using offers in place on 12 September". Figure 1.3 sets out the Tariffs that the Parties have proposed to be covered by this "Pricing Cap Commitment".*

The Pricing Cap Commitment does not take into account ongoing changes in market and consumer behaviour, for example by increasing the data allowances over time. The tariffs offered by the Parties under the Pricing Cap Commitment are likely to become obsolete in a relatively short period as 5G penetration deepens in the UK market and customer's monthly data usage increases.

If the CMA is to pursue the Pricing Cap Commitment as a remedy, and our preference is for a wholesale access intervention instead of this, we agree with the CMA that the protected tariffs should be "popular, competitively priced and span different data allowances". We question whether the Tariffs proposed by the Parties for the Pricing Cap Commitment meet this criteria. For example, a 1GB offer from Three priced at between £9 and £19 (depending on the length of contract) is not competitive in today's market and is unlikely to represent a meaningful percentage of Three's weekly gross acquisitions. It is therefore irrelevant to include these 1GB tariffs within the Commitment.

Again, our view is that an intervention to ensure competitive wholesale access terms – that allows MVNOs to compete across all data allowances – from low data allowances (e.g. 3GB) to unlimited data - will be a much more effective remedy to protect consumer interests and provide ongoing access to low prices.

Time limited Wholesale Access Terms

We set out below our view on the Wholesale Reference Offer as proposed by the Parties. There are a few issues which we consider to be problematic.

Firstly, the Parties have proposed a price per GB wholesale model for this remedy, with the price per GB tiered depending on the customer base size of the MVNO recipient of the WRO. We believe this structure is unlikely to generate meaningful interest from MVNOs, and therefore unlikely to be an effective remedy, for the reasons set out below.

A price per GB model is risky for MVNOs as it does not take into account future changes in consumer and market behaviour. Several MVNOs that have had enjoyed sustained success in the UK market have moved away from a price per GB model given the limitations that it presents to customer base growth and profitability. With a price per GB model, the customer usage risk – namely that a customer usage increases over time – sits with the MVNO rather with the MNO host, whose incremental cost per GB is marginal. Most credible forecasts expect average data usage in the UK to increase from the current 11GB in 2024 to at least over 50GB by 2028 (a CAGR of c.40%), driven by the increasing penetration of 5G and 5G enabled devices. With a price per GB model, this increasing customer usage leads to higher wholesale costs and reduces the retail margins of the MVNO, as well as its overall competitiveness and the risk profile for investment in customer acquisition.

Alternative wholesale models to price per GB include: fixed cost wholesale bundles (e.g. £2.50 for a 10GB offer), revenue share and margin share. These models encourage MVNOs to compete in the retail market as they limit the MVNOs risk in terms of customer utilisation and allow the MVNOs more retail pricing flexibility. They represent a more stable and sustainable basis to grow an MVNO customer base, and to compete across all data inclusions in the retail market, from low data to unlimited data. We believe the CMA should consider these alternative models as part of a wholesale remedy.

Furthermore, the introduction of tiered rates for MVNOs of varying sizes, whereby a new entrant has inferior terms than more established players, will not incentivise market entry for a new MVNO. This structural disadvantage for new entrants will not stimulate increased competition from new MVNOs [redacted] and would act as a disincentive to invest. In addition, the best tiered rate per GB is in our view unlikely to be as attractive as the current wholesale terms secured bilaterally by the larger MVNOs, which will also reduce take-up of the remedy.

Equally, we do not see the need for Minimum Revenue Guarantee (MRG) under the WRO or Wholesale Access terms. We agree with the CMA in 1.495 that these could increase the effective price of the Wholesale Access Terms and could perhaps also prevent the Wholesale Access Terms from being taken up. Our experience of previous MVNO businesses with MRGs as part of their wholesale arrangements, which we would be happy to share, supports this view.

With a price per GB model, indexation mechanisms are typically required to benchmark wholesale costs against a changing retail market. The Parties have proposed a “Future Pricing Mechanism” which could potentially allow an MVNOs wholesale pricing to change with reference to the Merged Entity’s average revenue per user (ARPU) and average data usage on the Merged Entity’s network. The proposed formula means that the wholesale price paid by the MVNO could potentially reduce when the Merged data usage per customer increases, or when the Merged Entity’s ARPU decreases. We have several concerns about this mechanic as proposed:

- By definition the indexation mechanic is a lagging "catch up" mechanic, meaning it allows wholesale price adjustments based on historic ARPU or data usage changes. If the market moves considerably in the period following the indexation review then the MVNO's ability to compete is restricted. The lagging rebase nature of wholesale rates via indexation, and the process that surrounds it, also places more bargaining power with the host MNO.

- The usage profile of a mature customer base such as the Merged Entity's, compared to a less mature MVNO base, is unlikely to be similar. Here, it is worth examining Vodafone's recent data usage per customer in the UK, where we believe average data growth per customer per month has slowed in recent years, in contrast to the data usage profiles of MVNOs.

- Equally, the Merged Entity's ARPU evolution is sensitive to CPI adjustments. For example, the recent period of high inflation will have supported the Merged Entity's ARPU.

It is therefore quite possible that the proposed FPM will not deliver wholesale price adjustments that respond to changing retail market conditions and customer usage patterns. An alternative could be to change the comparators and base an indexation mechanic on retail ARPUs and data allowances by price tier in the gross acquisition / switching market, rather than customer base ARPUs.

We note that with alternative wholesale models, such as a revenue or margin share, indexation mechanics such as the FPM would not be required. The MVNOs would not be exposed to margin compression from increased customer usage, a risk inherent with a price per GB model. These alternative wholesale models would also offer MVNOs more retail pricing flexibility, meaning they are more likely to offer consumers compelling offers at low prices.

For the above reasons, we fear that the take-up of the WRO will be limited and therefore will not drive the intended customer outcomes sought by the CMA, namely the promotion of effective competition by MVNOs in the retail market. We think MVNOs will prefer to seek wholesale access terms via bilateral negotiation. In this regard we agree with the CMA (1.474) that *"the "blueprint" terms of Wholesale Access Terms could be less attractive than what they would otherwise have negotiated".*

Existing MVNOs may prefer bilateral arrangements rather than mandated Wholesale Access Terms

We welcome the CMA's statement in subparagraph C of 1.474 that *"existing MVNOs of the Parties – for the period in which Wholesale Access Terms are in place- should have the choice of contracting on either: (i) their current contract terms (as adjusted for "future-proofing" mechanisms, and including re-contracting on their current contract lengths), or (ii) Wholesale Access Terms".*

We support this statement and would welcome a discussion with the CMA on the intention behind this specific point. [redacted].

In our view it is essential for existing MVNOs to have the flexibility and choice to remain on bilateral terms for a similar duration as the new Wholesale Access Terms, which "would last up to five years, therefore ensuring some continued effects for a total period of "8-9 years" (1.481).

However, we are concerned about the asymmetry in bargaining power between the Merged Entity and MVNOs post the approval of the Merger in the scenario that MVNOs seek to engage bilaterally to secure wholesale access. [redacted]

[redacted]

12th November 2024

Signed by ____________________ ....

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