# Telefónica UK's response to:

*Notice of proposed variation of Everything Everywhere's 1800MHz spectrum licences to allow use of LTE and WiMAX technologies*

**A consultation by Ofcom**

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

# Table of Contents



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

# 1. Executive Summary

1. Everything Everywhere and Ofcom (in this Notice) both believe that:

   a. The Merger Decision[1] has already considered the issues of liberalisation and timing, addressing any competition issues through the divestment remedy. This is the primary case made by Ofcom in the Notice; also and in any event

   b. Ofcom is required to liberalise all 900MHz and 1800MHz licences for LTE services by the end of 2012, by virtue of the Radio Spectrum Policy Programme Decision[2] (RSPP). This is the secondary case made by Ofcom and recently endorsed by Everything Everywhere[3].

2. The consequence of granting immediate liberalisation would be the creation of a monopoly provider of 4G national wholesale services for a period of at least 18 months and very likely substantially longer. This is an extraordinary step for a National Regulatory Authority to take, given its duty to promote competition and its stated policy of intervening *ex ante* to secure a four player 4G national wholesale market. Any such proposal must raise *prima facie* competition concerns.

3. Ofcom reaches its surprising conclusion on its primary case because it takes *"as established the Commission's conclusions that the commitments are sufficient to address the competition concerns the Commission identified"*[4], as such, the divestment remedy offered up at the time of the merger that formed Everything Everywhere ("EE"), has addressed the any competition issue identified by the Commission.

4. Telefónica was very surprised by these conclusions and therefore sought disclosure of relevant documents under the Freedom of Information Act (FOIA)[5]. The aim of the disclosures was to determine from the contemporaneous documents, what the scope of the Merger Decision covered and the objectives of the divestment remedy.

## *If the Merger Decision binds Ofcom, there can be no liberalisation until 30 September 2013*

5. If Ofcom and EE are correct, and the issue of liberalisation has already been dealt in the Merger Decision, then it is important to be clear on when liberalisation of licences is to be allowed under the terms of the Decision.

6. Paragraph 128 is the only one in the Decision that addresses the issue of liberalisation and timing. Unfortunately for Ofcom, it addresses the world where the merger has been cleared, but without a remedy, in a section of the Decision entitled *"Adverse Impact on Competition"*,

[1] http://ec.europa.eu/competition/mergers/cases/decisions/M5650_20100301_20212_247214_EN.pdf
[2] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:081:0007:0017:EN:PDF
[3] The Independent newspaper (i) 3rd May p.43
[4] §4.18 of the Notice
[5] http://www.ofcom.org.uk/foi-responses/april-2012-foi-responses/

ie the timing stated at §128 is something that the Commission did not wish to see arising as a result of the merger, it would have an "adverse impact on competition". Ofcom portrays this paragraph as laying out the assumptions under which the Commission cleared the merger,[6] this is patently untrue given the context within which paragraph 128 is written.

7. In contrast to the inferences Ofcom seeks to draw from irrelevant text in the Decision, it's FOIA disclosures provide a clear and unambiguous description of the objective for the merger remedy:

> *"To address the theory of harm relating to 1800MHz spectrum, the remedy would need to be aimed at ensuring that another operator could set up a LTE capability comparable to the JV in a similar period of time."*[7] *[our emphasis]*

8. In the evidence obtained under FOIA, Ofcom explicitly states there must be two LTE1800 players on the market at about the same time, not a monopoly.

9. It is unclear to Telefónica why Ofcom has not bothered to review its own contemporaneous documents on the merger before issuing this very important consultation.

10. If the remedy did, as Ofcom and EE claim, address the issue of liberalisation and timing, there must be two LTE1800 players on the market within a short timeframe of each other. If, as Ofcom claims at §§4.15-4.18 of the Notice, Ofcom is legally bound to follow the Commission's Decision then it follows that it would be unlawful for Ofcom to liberalise EE's licence before 30th September 2013 at the earliest. This is the earliest date at which the divestment will be useable by "*another operator*" creating an "*LTE capability comparable to the JV*".

*The Merger Decision and Remedy dealt with concentration of spectrum, not liberalisation*

11. However, both a plain reading of the relevant public documents and the FOIA disclosures demonstrate that EE and Ofcom are wrong to assert that the Merger Decision explicitly dealt with the issue of liberalisation.

    a. Both the Commission and Ofcom say, in terms, in both the Merger Decision and the FOIA disclosures, that the divestment remedy only addresses the structural issue created by spectrum concentration arising from the merger. The Commission did not address any other "theory of harm" through the remedy; and

    b. Ofcom says, in terms, in the FOIA disclosures, that the development of LTE technology and spectrum regulatory policy was too uncertain for it to form a proper view on liberalisation at the time of the merger in 2010. Ofcom identified that it retained the powers to deal with any *additional* competitive advantage arising from liberalisation, in due course, in light of the prevailing factual and legal matrix at the time that it was asked to liberalise. This explains the complete lack of contemporaneous Ofcom

[6] §4.11 of the Notice, "In its assessment, the Commission made the following assumptions….."
[7] PE 26(10) disclosed on 5th April 2012



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

documents discussing the issue of liberalisation and timing, either internally or with the Commission.

12. Ofcom's assertion at §4.15 of the Notice and in Figure 1 on p.12 is therefore plainly misconceived[8]. No reasonable body could conclude that

> *"the acquirer of the divestment would be capable of exerting effective competitive pressure on EE using the divestment spectrum up to three years after EE's earliest possible use of LTE…."*[9](our emphasis)

is compatible with

> *"ensuring that another operator could set up a LTE capability comparable to the JV in a similar period of time."*[10] (our emphasis)

13. Ofcom's FOIA disclosures show that in order for the merger remedy to adequately address the structural issue, Ofcom expected an effective divestment remedy to ensure that the LTE1800 services of EE and the divestment holder were available for use within a fairly short timeframe of each other. The definition of that date, 30th September 2013, was informed by Ofcom's then view of the much likely later timing of LTE1800 devices becoming widely available. The Parties to the merger, France Telecom and Deutsche Telekom ("the Merger Parties") supported this view that LTE1800 would not be possible before end 2013 in either the counterfactual case or after a merger clearance with a 2x15MHz divestment remedy, due to difficulties in clearing the spectrum.

14. At no point is an unfettered monopoly, in the form of a substantial first mover advantage lasting many months or even years, envisaged or endorsed by either Ofcom or the Commission. No FOIA disclosure identifies any implicit or explicit link in Ofcom's or the Commission's reasoning between the divestment and the liberalisation issue. Ofcom has had an opportunity to provide evidence of such a link; clearly it does not exist.

15. Whilst, no doubt, Ofcom should take the Merger Decision into account when forming its own view on liberalisation, the binding effect of the Merger Decision is limited to the narrow issue of spectrum concentration that the Commission itself resolved through the remedy. What may or may not be done with the spectrum that the Commission determined EE may retain is an entirely open question to be reviewed by Ofcom as a free-standing issue.

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

[8] *"The Commission took its decision in March 2010 in the knowledge that LTE could be deployed in the 1800MHz band at any point from that time onward subject to authorisation by Ofcom to do so."*
[9] §4.15 of the Notice.
[10] PE 26(10) disclosed on 5th April 2012

*Ofcom and EE are wrong on their secondary case too, there is no directly effective right to liberalisation*

16. Ofcom's view that an obligation to liberalise 900MHz and 1800MHz licences arises at the end of 2012 is clearly wrong on a plain reading of the RSPP and in light of the CAT's judgment (and Ofcom's own pleaded argument) in *Telefónica O2 Limited vs Ofcom*.

17. Under the RSPP a requirement arises to *undertake an authorisation process* for both 900MHz and 1800MHz spectrum for LTE, by the end of 2012. Nothing in the RSPP pre-determines the outcome of that process (which must be conducted in conformance with Article 14 of the Authorisation Directive), let alone gives any particular operator a sufficiently clear or precise right to a particular outcome. As a consequence, no directly effective right to liberalisation arises as a result of the RSPP.

18. Ofcom must make a free-standing decision about liberalisation on its merits by the end of 2012 for both 900MHz and 1800MHz licences. To suggest that there is a compulsion to liberalise, however, is simply wrong in law.

19. In addition to these legal, factual and analytical failings, it follows from the above that the Notice fails to comply with the obligation to consult contained within Article 14 of the Authorisation Directive. Ofcom has consulted on two justifications for immediate liberalisation, each of which is wrong. Ofcom must re-consult in order to address these analytical failings and the further consequential failings we set out below.

*Further failings that need to be addressed in a new consultation*

20. First, the most obvious consequential failing is that Ofcom has failed to update the Commission's analysis to account for the changes in the factual and legislative matrix since the Merger Decision was taken. Not least, Ofcom fails to address the striking divergences between the factual representations made by the Merger Parties to the Commission in the lead up to the Merger Decision and the quite different reality in 2012 of early clearance of 1800MHz spectrum, installed network equipment and the growing portfolio of LTE1800 compliant devices. LTE is at the heart of the JV's strategy[11], rather than a sideshow as suggested by the Merger Parties.

21. Secondly, given the content, direction and conclusions set out in the Notice, we are surprised that Ofcom does not consider a commercially negotiated wholesale agreement[12] between EE and Hutchison (or the prospect of such an agreement) to be relevant in either in regard to this Notice or the Combined Award. Details about such access arrangements constitute highly relevant information, without investigation and/or disclosure of which the consultation is evidently defective and/or unfair. This matter must be highly relevant to an

[11] Advertorial, Daily Telegraph 8th May (Business Section) p.4

[12] Following correspondence with Ofcom and in light of the 27th April FOIA disclosure, there appears to have been a commercial agreement on wholesale access at the time of the merger (of which Ofcom was aware as early as 2010 it appears), rather than an obligation arising from the merger.



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

equitable consideration of remedies, by all stakeholders, not just those with knowledge of existing wholesale arrangements.

22. Thirdly, Ofcom also fails to properly assess the relevant market into which LTE1800 services will be launched. In the 2007, 2009 and 2011 consultations Ofcom sought to rely on bifurcated product markets caused by higher quality mobile broadband technologies. Below, Telefónica demonstrates that LTE performance on an empty network is far superior to the performance of HSPA+ on a loaded 3G network, increasing the bifurcation risk. In the 2012 Combined Award consultation, Ofcom still viewed bifurcation risk as a possibility to which it should be alive. In fact, even the very risk of bifurcation was sufficient to warrant the proposal of *ex ante* intervention in the Combined Award, notably in the form of spectrum caps and reserved spectrum. Yet, in contradiction to this approach, Ofcom now proposes to take action that in effect grants EE a wholesale monopoly over the high quality/high speed part of that bifurcated market for at least 18 months. Ofcom takes no account of its stated policy preference for four credible national wholesalers to be on the market in order for competition to be effective, such that the interests of consumers are best served.

23. Given the amount of time and effort Ofcom has devoted to that point over the last five years, we would expect it to have sufficient substance to remain a relevant consideration. In particular, we would expect Ofcom to undertake a proper market definition exercise since, if a bifurcated market or sub-market arose (e.g. in high speed data dongles or LTE-enabled mobile devices such as laptops, netbooks or tablets), this would mean Ofcom was, by liberalising to permit an LTE 1800 service, creating a monopoly provider with SMP in a new technology in a fast moving and dynamic market for a substantial period. Such a decision would be unlawful.

24. Fourth, Ofcom fails procedurally by not conducting any quantified Cost-Benefit Analysis ("CBA"), notwithstanding that this is required in order to reach a decision that is sufficiently robust to withstand profound and rigorous scrutiny. It has also failed to request any relevant information from Everything Everywhere, in order to fashion a CBA and inform its decision-making.

25. Telefónica has provided Ofcom with its own analysis of the negative impact on consumers caused by the monopoly rents charged by a single national wholesaler. Consumers will be over charged by at least [✂ over £100m]. If the auction is delayed by another twelve months, for example, these costs would rise to nearly [✂ many £'00m]. This cannot be in the interests of consumers. Ofcom must promote competition through its decision, in order to erase these monopoly rents.

*New consultation required*

26. We have shown that, if Ofcom and EE persist with their primary case, such that liberalisation has already been effectively approved by the Merger Decision, then, in light of the terms and

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

construction of the remedy, liberalisation cannot be lawfully authorised before 30th September 2013.

27. In light of the FOIA disclosures, Ofcom cannot sustain its proposal for immediate liberalisation contained in the Notice. The fact that EE now (somewhat belatedly) feels it needs to lobby to get immediate liberalisation[13] suggests to Telefónica that EE does not have much faith in the justifications put forward in the Notice either.

28. A proper consultation, supported by a rigorous cost-benefit analysis, would enable Ofcom to undertake an LTE authorisation process for 900MHz and 1800MHz licences with a full and transparent view of the facts, which will ultimately benefit all stakeholders and ensure a more considered and defensible outcome.

29. Telefónica does not share Ofcom's interpretation of the binding effect of the Merger Decision (properly construed). In light of the FOIA disclosures, we do not believe that any review body requested to revisit the issue in a profound and rigorous manner by reference to the current facts and market conditions, would reach the same conclusions as Ofcom in this Notice.

30. In view of these multiple and material defects of the Notice, we strongly urge Ofcom to re-consult fully and fairly on this matter in its entirety. Everything Everywhere accepts that it will not be ready to launch 4G until the end of this year[14], so there is plenty of time for Ofcom to consider the issue properly.

31. A proper consultation, undertaken with a full and transparent view of the facts, supported by a rigorous cost-benefit analysis would enable Ofcom to make quicker and more substantial progress on its obligation to undertake an LTE authorisation *processes* for 900MHz and 1800MHz licences by the end of this year.

**Telefónica UK Limited**
**May 2012**

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

[13] www.4gbritain.org
[14] http://www.bloomberg.com/news/2012-02-23/everything-everywhere-to-become-first-u-k-carrier-to-offer-4g.html

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

## 2. Legal framework

*Relevant legislation*

32. Ofcom correctly identifies that the 3G RSC Decision[15], as amended by the LTE RSC Decision[16], creates an obligation on Ofcom to "*make available*" the 900MHz and 1800MHz bands for LTE. Telefónica understands that Ofcom has complied with its obligations.

33. Again, Ofcom correctly interprets the relevant case law in *Telefónica O2 Limited vs Ofcom ("2G Liberalisation")*.[17] Indeed, Ofcom's argued case in those proceedings, which the Tribunal accepted, was as follows (§128):

> "*Miss Rose for OFCOM explained that the delay in the determination of the application by O2 for licence variation was at the request of the government. She described the purpose of the EU legal instruments as being to ensure that Member States promote the harmonisation of the radio frequencies by removing the legal obstacle in the original GSM Directive, in order that the 900 and 1800 MHz bands can be used with UMTS technology. It is not obliged to grant a right to any individual undertaking or operator to use or deploy the spectrum. The obligation to "make available" is not a directly effective right to use the spectrum for UMTS as O2 had claimed, since the provisions were not sufficiently precise and unconditional.*" [our emphasis]

34. In its judgment at §85, the Tribunal concluded that

> "*...it is clear from article 14 of the Authorisation Directive that conditions attaching either to general authorisations or specific authorisations in the form of rights of use can only be amended in certain delineated situations, in particular after notice has been given and a consultation exercise has been undertaken. This is a mandatory provision, and we think it would be more than surprising if a subsequent directive were to cut across it without making it clear that it was doing so.*"

35. The Radio Spectrum Policy Programme Decision, No. 243/2012/EU ("RSPP") now requires Ofcom to carry out an authorisation *process* by 31 December 2012 (Article 6.2). But as we explain below, the RSPP also makes it clear that the outcome of that process by no means a foregone conclusion: on the contrary, the RSPP expressly states that it is without prejudice to Member States' obligations under the Authorisation Directive (Article 1.2) and re-emphasises the UK's obligation to promote effective competition, including by refusing where appropriate to grant new spectrum uses (Article 5).

[15] Decision 2009/766/EC
[16] Decision 2011/251/EU
[17] 2010 CAT 25, Case Number 1154/3/3/10

*There is no obligation to authorise by the end of 2012, creating a directly effective right*

36. No existing licensee has a directly effective right to have its licence liberalised, either arising from the 3G RSC Decision, as amended, or from the RSPP. The Authorisation Directive is the determinative piece of legislation. It follows from CAT's reasoning in *2G Liberalisation*, that any piece of EC legislation that seeks to override the obligations contained in the Authorisation Directive would need to do so in a clear and unambiguous manner.

37. Moreover, any earlier Commission Decision or decision of a related national regulatory authority can in law be at most an input into the decision-making process required of Ofcom under the Authorisation Directive. It cannot in law be determinative of the issues Ofcom must decide. That is so even if the earlier decision is directly on point. It is still more obviously so where the earlier decision is directed at a different problem at a different time.

38. We are surprised, in light of the decision in *Telefónica O2 vs Ofcom*, by Ofcom's assertion at §3.7 of the Notice, to the effect that there is an obligation 'to authorise the use of' the 1800 MHz band arising from the RSPP.

39. The relevant elements of the RSPP are:

    a. Recital (19): "*In line with the objectives of the Digital Agenda for Europe, wireless broadband could contribute substantially to economic recovery and growth if sufficient spectrum were made available, rights of use of spectrum were awarded quickly, and trading were allowed to adapt to market evolution. The Digital Agenda for Europe calls for all Union citizens to have access to broadband at a speed of at least 30 Mbps by 2020. Therefore, the spectrum that has already been covered by existing Commission Decisions should be made available under the terms and conditions of those Decisions. Subject to market demand, the authorisation process should be carried out in accordance with Directive 2002/20/EC by 31 December 2012 for terrestrial communications, to ensure easy access to wireless broadband for all, in particular within frequency bands designated by Commission Decisions 2008/411/EC, 2008/477/EC, and 2009/766/EC*[18]*. In order to complement terrestrial broadband services and ensure the coverage of most remote Union areas, satellite broadband access could be a fast and feasible solution.*"

    b. Article 6(2) : "*In order to promote wider availability of wireless broadband services for the benefit of citizens and consumers in the Union, Member States shall make the bands covered by Commission Decisions 2008/411/EC (3,4–3,8 GHz), 2008/477/EC (2,5–2,69 GHz), and 2009/766/EC (900/1800 MHz) available under terms and conditions described in those decisions. Subject to market demand, Member States shall carry out the authorisation process by 31 December 2012 without prejudice to the*

[18] Commission Decision 2009/766/EC of 16 October 2009 on the harmonisation of the 900 MHz and 1800 MHz frequency bands for terrestrial systems capable of providing pan-European electronic communications services in the Community (OJ L 274, 20.10.2009, p. 32.).



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

*existing deployment of services, and under conditions that allow consumers easy access to wireless broadband services.*"

40. We consider that Ofcom has erred in its interpretation of the legal obligations arising under the RSPP. The RSPP's wording is clear and unambiguous in that Member States shall carry out an authorisation process by 31 December 2012. It does not, contrary to Ofcom's suggestion in the Notice, impose any "*requirement to authorise*". As we have noted above, the requirement is that the authorisation process shall be followed, not that the outcome of that process shall be determined by the Decision; and in consequence it is impossible for any directly effective right to a licence variation to arise by virtue of the RSPP. For instance, the authorisation process may determine that conditions should be placed upon any authorisation, that authorisation should be delayed or that authorisation in the form sought should be refused.

41. The above conclusion is reinforced by the fact that Article 6 of the RSPP is juxtaposed with Article 5 ("Competition"). Article 5 reiterates the obligations upon Member States to take into account competition issues when conducting authorisation processes, and emphasises that the outcome of such a process may be that the Member State refuses to authorise new uses to avoid any distortion of competition.

42. In conclusion, the RSPP cannot create a long-stop date for variation of EE's 1800MHz licence, just as it does not create a long-stop date for variation of any 900MHz or 1800MHz licence. What the RSPP does do is to require that Ofcom shall have completed an authorisation process for all 900MHz and 1800MHz licences by the end of this year i.e. that all NRAs shall have given this issue consideration (and conducted an Authorisation Directive-compliant process of consultation) by the end of 2012.

43. We look forward to Ofcom consulting properly and thoroughly on LTE liberalisation for the 900MHz and 1800MHz licences in due course. In completing the authorisation process by the end of the year Ofcom would both discharge the UK's obligations under the RSPP and allow Ofcom to rely on the availability (at some point in the future / subject to conditions) of LTE900 and LTE1800 in the decision on the Combined Award. In their present formulation, however, Ofcom's proposals appear to us to be vitiated by a material misunderstanding of the relevant legal instruments.

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

## 3. The case made by Ofcom in the Notice

44. In this section of our response we summarise the case for immediate liberalisation made by Ofcom in the Notice.

*The European Commission approved the merger with remedies on the assumption that 1800MHz would be liberalised ahead of the availability of 800MHz and 2600MHz*

45. At §4.10 of the Notice Ofcom sets out its primary case that, essentially, the European Commission has already addressed any competitive distortions arising from liberalisation of 1800MHz through the Merger Decision and the Commitments extracted from the Merger Parties, France Telecom / Deutsche Telekom.

> *"Pursuant to this notification, the Commission considered whether the transaction would significantly impede effective competition in the common market or a substantial part of it. In doing so, the Commission assessed the incremental effect of the T-Mobile/Orange concentration on the assumption that the 1800 MHz spectrum would be authorised for LTE use in advance of the 800 MHz and 2.6 GHz spectrum becoming available for such use. In undertaking this assessment, the Commission identified a concern that the combined entity could be the only MNO with a clear path to full coverage maximum-speed LTE technology in the UK, as against the counterfactual that there would be two MNOs in that position, with 1800 MHz spectrum, in absence of the merger. The Commission felt that a merger without remedy could result in a bifurcation of the market in years to come, with the combined entity being the only MNO in the UK able to offer LTE technology at the best possible speeds with full coverage."*[19] [our emphasis]

46. Ofcom identifies the key assumptions made by the Commission at §4.11, namely:

    a. 2600MHz spectrum would be available for use for LTE services immediately after the auction, i.e. early in 2011 on the then expected timescale; and

    b. 800MHz would be available for such use later, towards the end of 2013 / beginning of 2014.

47. This assessment of the availability of substitute spectrum draws[20] on the public version of the Merger Decision at §128:

> *"The Commission considers that it is indeed possible that other LTE networks could be launched by coupling sub 1000MHz spectrum (i.e. at the 800 or 900 MHz level) and 2600 MHz spectrum which will be auctioned in the coming years. However, there are strong grounds to conclude that the [Merger Parties] would still have a*

[19] §4.10 of the Notice
[20] Ibid §4.11

> *significant technological and marketing advantage over competitors. In particular, the parties will be able to offer superior network quality in terms of maximum download speed, and potentially also in terms of consistency of provision of lower download speeds. The [Merger Parties] will also have a significant time advantage due to the uncertain timing of the auction and the time needed to clear the sub 1 GHz spectrum. In addition, the 2600 MHz spectrum presents lower coverage performance compared to the 1800 MHz spectrum, which makes it hardly suitable for areas other than urban.*" (our emphasis)

48. On the basis of the one sentence underlined above, Ofcom (wrongly, as we show below) suggests at §4.11 of the Notice that the Merger Decision addresses the issue of the relative timing of the availability of different forms of LTE[21] through this paragraph.

49. It is clear from the text of the Merger Decision that:

    a. the Commission envisages that liberalisation will have taken place *before* 800MHz is available, due to the delayed clearance; but

    b. the Commission makes no comment in the public record regarding:

        i. The actual timing, terms and manner under which any liberalisation decision will be reached; and

        ii. The relative timing of 2600MHz availability (then assumed in 2011) and any decision to liberalise 1800MHz.

50. In the Decision there is no discussion of any monopolistic position in LTE being authorised under the Merger Decision or in any associated liberalisation decision by Ofcom. The Commission makes no comment in the document about authorising liberalisation.

*The merger remedy dealt with the structural issue of spectrum holdings as well as liberalisation and timing*

51. Ofcom characterises the Commission's Merger Decision thus, at §4.14 of the Notice:

> *"The Commission considered these commitments were sufficient to address the competition concerns it had identified. As a result, it cleared the proposed transaction by declaring it compatible with the common market and with the functioning of the EEA agreement. In reaching this decision, the Commission was satisfied that any advantage accruing to EE from being the only undertaking with a clear path to full coverage maximum-speed LTE technology in the UK up until the divestment spectrum could be used by another operator to provide LTE services did not significantly impede effective competition in the common market or a substantial part of it.*"

[21] *"The Commission also noted that the merging parties would have a significant time advantage due to the uncertain timing of the auction and the time needed to clear the 800MHz spectrum."*

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

52. The breadth of this conclusion is unsustainable.

53. Under the heading "*Adverse impact on Competition*", the Merger Decision discusses the potential negative effects of the Merger at §§122-134. Specifically the Commission identifies its concern as a *structural* one, that is one directed at the potentially superior quality of a LTE network based exclusively or largely around 1800MHz spectrum. The Merger Parties would, absent intervention, hold 2x60MHz contiguous of the 2x71.6MHz available such that:

> *"The [Merger] parties [could] have the only full-speed national LTE network in the short to medium term"*[22] *[our emphasis]*

54. The Commission concludes at §138:

> *"In view of the above, the Commission informed the parties on 29 January [2010] that it had identified* prima facie *serious doubts as to the merger's compatibility with the common market in relation to the wholesale and retail telecommunications markets over the next few years as a result of the 1800MHz band spectrum concentration deriving from the merger."* [our emphasis]

55. The Commission's concern as articulated in the public version of the Merger Decision is clearly one of concentration of spectrum holdings, i.e. a structural concern. At no point other than at §128 does the Merger Decision address the issue of liberalisation and timing. Ofcom therefore needs to demonstrate both that:

    a. the merger remedy addresses the structural issue clearly identified in the Merger Decision; and

    b. (by implication, for it is clearly not explicit in the Decision) the remedy also address *any* competition issues that might thereafter arise as a result of Ofcom's liberalisation decision (which was, Ofcom asserts, envisaged by the Commission), and more particularly the issue of the creation of a substantial 4G wholesale monopoly by early liberalisation.

56. Ofcom, at §4.15 of the Notice seeks to infer that this is indeed the case:

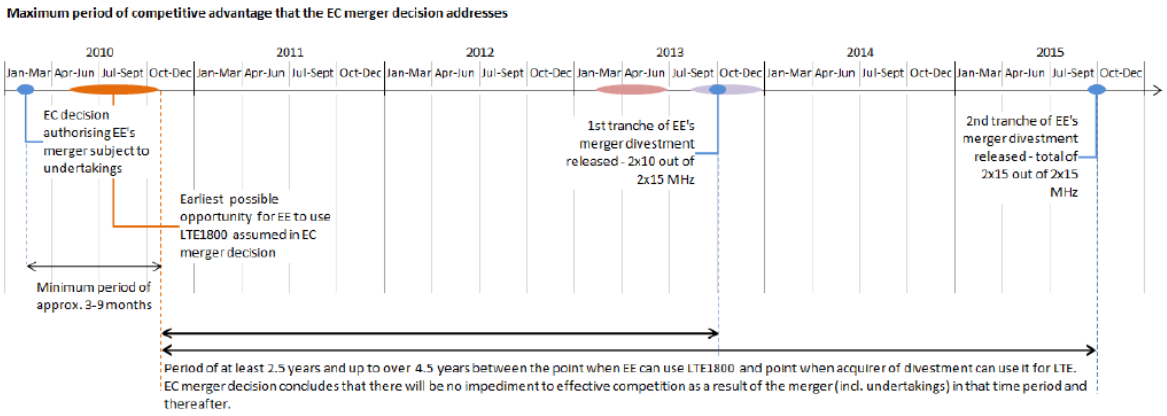
> *"The Commission took its decision in March 2010 in the knowledge that LTE could be deployed in the 1800MHz band at any point from that time onward subject to authorisation by Ofcom to do so. The Commission therefore considered that the acquirer of the divestment spectrum would be capable of exerting effective competitive pressure on EE using the divestment spectrum up to three years after EE's earliest possible use of LTE for the first tranche of 2x10 MHz of the divestment and up to five years for the full divestment of 2x15 MHz. As two years have passed since the date of the Commission's decision, these time periods are now in fact considerably shorter."*

[22] §122 of the Merger Decision



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

57. Ofcom supports this position with its diagram at Figure 1 in the Notice, entitled *"Maximum period of competitive advantage that the EC merger decision addresses"*.




58. Ofcom seeks to infer that the divestment spectrum itself, which may not be available and cleared for use until at least September 2013, is envisaged by the Commission as placing the competitive constraint on EE's launch of LTE1800 as early as October 2010.

59. Thus Ofcom relies on the Commitments themselves as being the remedy that would address any competition issue arising from liberalisation from December 2010.

### *Ofcom is bound by the Merger Decision to allow liberalisation*

60. Ofcom implies at §4.18 that the competitive effects of liberalisation are one of *"the competition concerns the Commission identified"* in the Merger Decision and that it follows therefore that the Commitments themselves are *"sufficient to address"* these concerns.

61. In light of this logic, Ofcom feels that it is bound by Article 21 of the EC Merger Regulation, not to re-open the issue of liberalisation in reaching its conclusions put out to consultation in this Notice.

### *In any event, Ofcom must liberalise 900MHz and 1800MHz by the end of 2012*

62. Ofcom asserts, at §3.7 of the Notice that the Radio Spectrum Policy Programme[23] places a *"requirement to authorise such use [high speed electronic communication services] of the spectrum"* by the end of 2012.

63. Essentially, Ofcom is asserting that a directly effective right arises by virtue of the RSPP. We note at this stage that, if this were true, Ofcom would be required to issue a similar notice in relation to 900MHz (whether or not an application for a licence variation is made), yet no such notice has been forthcoming.

[23] http://register.consilium.europa.eu/pdf/en/11/st16/st16226.en11.pdf

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

# 4. Ofcom is wrong on all counts

64. In this section we examine each element of Ofcom's stated case for liberalisation and disprove each point. We draw on published documents, such as the Notice and the Merger Decision, and also on information provided by Ofcom pursuant to a request under the Freedom of Information Act 2000 (FOIA).

65. Telefónica UK served Ofcom with that FOIA request on 27th March 2012, seeking information in relation to Ofcom's consideration of the merger and its advice to the European Commission, at the time the merger was announced in 2009 and during the clearance process between January 2010 and 1st March 2010. While we consider Ofcom's response to that request to have been inadequate, our assessment of the relevance (or otherwise) of the Merger Decision by the Commission to the consideration of liberalisation is nonetheless greatly informed by the documents provided by Ofcom on 5th April 2012 and subsequent further disclosures on 16th April[24], 27th April and 1st May. It is unclear to us why Ofcom failed to study its own archive, before publishing this Notice.

66. When assessing the objective of the divestment remedy in particular, it is important to understand both the timing and the context of any comment made by the Commission or Ofcom, as it is clear from the disclosures that both the theories of harm and the factual matrix developed considerably in the period from October 2009 to March 2010.

*The Commission approved the merger with remedies to address the issue of spectrum concentration*

67. In the run-up to notification of the merger, and during the Phase I process itself, the Commission and Ofcom exchanged views on various theories of harm that might arise from the proposed merger. These theories of harm developed over time and varied in their explanation.

68. The first real consolidated list of theories of harm was produced by Ofcom in a memo to DG Competition of 21st December 2009. It identifies four theories at this stage:

    a. The removal of T-Mobile as a retail competitor;

    b. The ability and incentives to weaken H3G's position post-merger;

    c. Reduced incentives for the JV and other MNOs to offer competitive access terms to MVNOs post-merger; and

    d. The JV's spectrum holdings *"will give it a stronger foothold in the development of LTE that will enable it to build an entrenched market position in the future".*

69. By 7th January in a memo produced ahead of a meeting with the Commission, Ofcom condenses its description of these theories of harm to:

[24] http://www.ofcom.org.uk/foi-responses/april-2012-foi-responses/

a. Potential reduction in retail competition through

   i. Exit of T-Mobile; and

   ii. The potential weakening of the position of H3G in the market

b. Potential reduction in wholesale access competition and provision of access to MVNOs which would lead to a reduction in retail competition; and

c. Potential reduction of competition through the Merger Parties' combined spectrum holding in the 1800MHz band.

70. At 26th January[25] the description of the three theories of harm had changed again:

a. Impact on H3G's 3G RAN sharing agreement with T-Mobile;

b. The joint venture's ability to build an entrenched position of dominance by virtue of its large holding of 1800MHz spectrum; and

c. The general impact on competition by moving from 5 to 4 competing MNOs, and in particular from losing T-Mobile as a competitor.

71. Ofcom was of the view that none of these theories of harm could be adequately explored without a Phase II review.

> *"We believe that there are a number of potential theories of harm that would need to be reviewed in detail. This is unlikely to be possible unless the Commission opens a Phase-II investigation (or the proposed transaction is referred to the Competition Commission if the OFT's likely request for a referral back to the UK is accepted."*[26] [27]

> *"we think that the proposed JV poses some potential competition concerns, although it is not yet clear whether these could be sufficient to justify blocking or imposing conditions on the JV. Dealing with these questions requires an in-depth review (that is, a Phase II investigation)...."*[28]

72. As time went on, Ofcom and the Commission focused in on the structural issues, such as to whether the concentration of spectrum gives rise to an "SLC" (Significant Lessening of Competition) in the spectrum market, which was identified as early as October 2009.

> *"Will the combined entity's spectrum holdings (e.g. in 1800MHz) result in an SLC in any spectrum market?"*[29]

73. It is clear from the Commission's own description of its "serious doubts" letter to the Merger Parties of 29th January 2010, that the spectrum-related "theory of harm" it sought to address was that of concentration[30].

[25] Guidance document to Ofcom's Policy Executive
[26] Ibid, Attachment 2, p.11
[27] Repeated in Ofcom Board paper of 26th November 2009
[28] Ibid Internal Memo dated 7th January 2010, Attachment 2, p.35
[29] Ibid Attachment 1, p.31, 29th October 2009



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

> *"In view of the above, the Commission informed the parties on 29 January [2010] that it had identified prima facie serious doubts as to the merger's compatibility with the common market in relation to the wholesale and retail telecommunications markets over the next few years as a result of the 1800MHz band spectrum concentration deriving from the merger."* [our emphasis]

74. At no point in the evidence disclosed by Ofcom does it raise the issue of LTE liberalisation with the Commission or provide any view of the potential impacts on the mobile wholesale and retail markets – and consequently the downstream impact on consumers – associated with such liberalisation. This is something that we would have expected to figure heavily in the correspondence, if the merger remedy was specifically designed to address all three issues of concentration, liberalisation and timing within the context of Ofcom's statutory duty to promote competition in the interests of consumers.

75. It is particularly telling to note in this context Ofcom's internal memo of 5th January 2010. This identifies a broader theory of harm than the pure concentration of holdings:

> *"Will the merged entity's consolidated spectrum holdings in 1800MHz provide it with an advantage in deployment of 4G mobile networks (specifically LTE) that would lead to a substantial impediment to effective competition?"*

76. There are three elements identified that contribute to this concern, specifically that the merged entity will:

    a. *"be the only network currently holding sufficient suitable spectrum to deploy a LTE network offering higher speeds than 3G"* – a concern about concentration

    b. *"have sufficient 1800MHz spectrum to provide the highest speed LTE services (using 2x20MHz) with moderately good coverage. Bands available to other operators either have poorer coverage (2.6GHz) or do not have sufficient bandwidth to offer the highest speed services (800MHz and 900MHz)"* – a concern about non-replicable capability; and

    c. *"be able to clear 2x20MHz of 1800MHz spectrum of existing (2G) use, and hence make it available for LTE faster and/or cheaper than if the parties remain separate"* – a concern about timing.

77. In the same document, however, Ofcom clearly identifies that any of these problems could be solved by one of two methods[31]:

> *"How the concern could be addressed*
>
> - *Through the merger*
>
>  - *Divestment of 1800MHz spectrum*
>
>  - *Access to deployed networks {deployed} 1800MHz spectrum*

[30] §138 of the Merger Decision
[31] Ofcom internal memo of 5th January 2010 [16th April 2012 disclosure]



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

- *Constraints on deploying LTE for a period of time (perhaps limits over sites / speeds offered) [but unattractive from consumer perspective]*

- *Leave any potential problem to be addressed through future Ofcom regulatory decision over liberalisation of 1800MHz spectrum for LTE (at which point there may be better information)*"

78. This is repeated at pages 7-8 of a memo of 7th January 2010, ahead of a meeting with the Commission. In both documents Ofcom identifies that there is much evidence gathering to be undertaken before it can form a firm view. In particular, in the 7th January memo it identifies the issues of:

    a. Timing

        i. How much faster and cheaper could the JV bring LTE1800 to market (absent remedies)?

        ii. When can operators holding 900MHz spectrum clear enough for LTE in order to respond?

        iii. What is the expected timing of LTE equipment availability? – This is noted as a particularly uncertain piece of information

    b. How significant is the (non-replicable) advantage the merged entity could have over other operators. Specifically, how much better will LTE services using 1800MHz be than services offered using suitable spectrum available to other operators?[32]

79. Towards the end of the Phase I review, Commitments were offered by the Merger Parties in order to address two theories of harm, those relating to the future of Hutchison in the 3G RAN share and spectrum concentration.

### *No national LTE monopoly was ever envisaged*

80. Under the heading "*Adverse impact on Competition*", the Merger Decision discusses the potential negative effects of the merger at §§122-134. The Commission envisages the market absent the merger would have a number of competing "*mixed frequency LTE network(s)*".[33]

81. Alternatively, full [national] coverage LTE networks might be possible before the availability of 800MHz spectrum, if MNOs pooled their 1800MHz spectrum[34]. In the absence of the merger "*it seems likely that more than one LTE network could emerge in the UK*".

[32] As we shall show later, Ofcom's view has changed markedly from March 2011 to January 2012, in that it now believes that large volumes of 1800MHz spectrum are as good as or better than sub-1GHz spectrum, depending on the relevant measure. At the time of the merger, Ofcom viewed 1800MHz as a poor substitute.
[33] §135 of the Merger Decision
[34] Ibid §136



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

82. Specifically the Commission identifies its concern as a structural one

> *"The parties [could] have the only full-speed national LTE network in the short to medium term, since the amount and type of spectrum held by an MNO dictates its ability to launch a LTE network as well as the speed of that LTE network"*[35] [our emphasis]

83. It is important to unpack this statement. The conditions the Commission is concerned about are:

    a. Monopolism in general and specifically

    b. The national nature of the monopolistic LTE offer

    c. The headline LTE speed that the JV would be able to offer; with

    d. The relevant timeframe being the short to medium term. However, it is clear from the Commission's stated reason for its concern ("*since…*") that the Commission is *not* envisaging a monopoly created by an early liberalisation decision, but advantages caused by the properties of a large 1800MHz holding (i.e. the concentration issue).

84. There are many echoes here of Ofcom's own concerns regarding the number of "credible national wholesalers" that should emerge from the Combined Award.

*The timing of the divestment relates to re-creating the counterfactual spectrum market conditions, rather than as a remedy for early liberalisation*

85. It is clear from the above that the relevant theory of harm addressed by the Commitments is that of spectrum concentration. Further, at §§135-137 of the Decision, in the discussion about the counterfactual, it is clear that the Commission envisages two LTE1800 based networks emerging in the longer term (those of the Merger Parties) absent the merger. Through the divestment remedy the Commission seeks to return the market to the position pre-merger, removing the monopolistic ability to deploy LTE1800 identified by the Commission.

86. In an Ofcom Policy Executive Paper[36] a few days before the "serious doubts" letter was issued (on 26th January 2010) Ofcom sets out its views on the relevance of the timing of the proposed divestment remedy.

> "***1800MHz spectrum***
>
> *To address the theory of harm relating to 1800MHz spectrum, the remedy would need to be aimed at ensuring that another operator could set up a LTE capability comparable to the JV in a similar period of time.*

[35] §122 of the Merger Decision
[36] PE 26(10) disclosed on 5th April 2012



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

> *This would imply requiring the JV to divest a sufficient amount of spectrum. The question is when how much spectrum would be enough for the JV to divest.*" [our emphasis]

87. Ofcom and the Commission are seeking to recreate the spectrum market conditions absent the merger, whereby two licensees have the opportunity to include LTE1800 in their future networks. Both these licensees must have the opportunity to do so **at about the same time**.

88. The determining factor here is not liberalisation but:

    a. The likely availability of LTE1800 equipment; and

    b. The likely time taken to clear sufficient 1800MHz divestment spectrum to create a competitor with sufficient 1800MHz to launch a comparable LTE1800 service.

89. It is clear from Ofcom's disclosures that this was a bit of a balancing act. If too much spectrum were sought then the remedy itself might delay the availability of LTE1800 beyond a point where the relevant network equipment and devices were on the market. Too little spectrum would not create as sufficient a competitive constraint as was required by the identified theory of harm. A detailed exploration of this issue can be found at pages 5-7 of the Ofcom Policy Executive paper of 26th January 2010.

90. If it was important to Ofcom and the Commission that the remedy should not, of itself, unduly delay the launch of LTE1800, Ofcom and the Commission must have had some working hypothesis for when LTE1800 equipment and devices would be available. As early as October 2009 (at §60 of a Memo) Ofcom identifies that LTE1800 equipment will emerge *later* than that for 2600MHz and 800MHz. The key question therefore, is how much later? The uncertainties around equipment timing are identified as a key area for further study in the 5th January memo, but Ofcom accepts that

> *"this will still remain uncertain to some degree even after seeking additional evidence"*

91. In the presence of such uncertainty, the contemporaneous evidence strongly suggests that Ofcom and the Commission focussed on reproducing the conditions in the counterfactual at a reasonable point in the future, rather than seeking to address the issue of liberalisation timing through the remedy. Indeed, there is no discussion of liberalisation at all in the disclosed documents.

92. In agreeing to the timing of the divestment of 30 September 2013, Ofcom and the Commission envisage that two LTE1800 networks would need to be viable within a short timeframe of each other. In other words, the divestment date was tied to when it was thought a LTE1800 service might first be capable of being launched (with devices available and spectrum cleared) in the counterfactual market without the merger. In arriving at that decision the submissions of the Merger Parties will have been taken into consideration, in particular the submissions of the Merger Parties with regard to the counterfactual.

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

*"Absent the merger, the individual Parties might in principle be able theoretically to clear sufficient spectrum to start roll-out of a [2x]10MHz LTE network each within the medium term (the end of 2013)."*[37]

93. In structuring the remedy, Ofcom and the Commission sought to get both sufficient spectrum to provide a competitive constraint on EE, and such spectrum within a timeframe consistent with the Merger Parties' assessment of the counterfactual.

94. The Merger Parties stated that clearing spectrum for LTE would not be a priority of the JV and could not be seriously contemplated until 2013 at the very earliest[38].

*"Even if available resources were focussed on this activity, the Parties estimate that it would not be possible to clear 20MHz of 1800MHz – allowing a [2x] 10MHz deployment – before 2013" [our clarification]*[39]

*"...24 Months [ie March 2012] is believed to be a reasonable estimate of the time needed to clear the 1800MHz spectrum if resources are available and dedicated to the task. However, for the JV, this will not be the case. As described elsewhere, the JV will have higher priorities to modernise and optimise the 2G network for voice, possibly involving a change of vendor, and to consolidate the 2G and 3G networks, both resource intensive processes. Moreover, the proper planning work for nay of these activities cannot begin until the JV has been agreed by the competition authorities.....We estimate the pressure of other JV tasks would extend the time needed to clear the spectrum by a year, taking the full elapsed time to three years, ie 2013/14" [our clarification]*[40]

*"The Parties estimate that it would take at least two years to clear 2x10MHz of 1800MHz spectrum, without the resource constraints of realising JV network improvement synergies and completing the initial consolidation of the T-Mobile UK and 3UK 3G RANs. As such, the earliest expected date for the JV to start providing LTE services using 2x10MHz of is 2013, with possibility for further delays. It would take significantly longer for the JV parties to clear sufficient spectrum to launch 2x20MHz"*[41]

95. In fact, the Merger Parties felt that 2014 or later was a more likely outcome in the face of the 2x15MHz remedy. The two tranche structure of the divestment[42] reflects the submissions of the Merger Parties that the JV would only be able to initially launch with a 2x10MHz service, adding further weight (if any were needed) that the remedy is a structural one relating to enabling two operators to have at least 2x10MHz services on the market towards the end of 2013.

[37] Ibid – p.11
[38] Ofcom disclosure of 27th April
[39] Ibid p.4
[40] Ibid p.6
[41] Ibid – RBB Economics report p.14 of the disclosure
[42] 2x10MHz by 30 September 2013 and a further 2x5MHz by 30 September 2015

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

96. It is Telefónica's strong view that the FOIA disclosures demonstrate the complete lack of any discussion of liberalisation or the timing thereof between Ofcom and the Commission and that the sole focus of the remedy in the Merger Decision was to address concentration.

97. The FOIA disclosures secured by Telefónica show that even on Ofcom's own case, if the Merger Decision had addressed liberalisation through the divestment remedy (which it did not), the competitive constraint on liberalised LTE1800 spectrum from EE was the availability of LTE1800 by the divestment holder at roughly the same time, again, sometime around the end of 2013.

98. The suggestion at §4.15 and Figure 1 of the consultation, that Ofcom and the Commission both (secretly) authorised liberalisation for EE at the end of 2010 (subject to the right enabling legislation) and that this was specifically designed to allow up to three years first mover advantage is simply without foundation in any of the contemporaneous documents which Telefónica has had the opportunity to examine.

*Ofcom accepted that the issue of liberalisation was too uncertain to predict at the time of the merger, so it could not have been the subject of the remedy*

99. When reviewing the Commitments, Ofcom accepted that there were risks that the proposed divestment might not solve all potential competitive problems and that these theories of harm had not been explored fully due to the absence of a Phase II investigation[43].

> *"The central risk to accepting remedies is that we reach the wrong conclusions and advise the authorities to permit a merger (even with undertakings) that acts against the consumers' interest in the longer run.*"

100. The contemporaneous documents produced by Ofcom show that it recognised that the issues of liberalisation and timing were currently too uncertain to reach any safe decision on.

> *"the timing of LTE equipment is currently somewhat uncertain and therefore the extent of the additional advantage from earlier spectrum availability is unclear."* [44]

101. Ofcom had already identified as early as 5th January 2010 that, through a future liberalisation decision, it would have the facility to address any additional advantage that might accrue due to the timing of LTE equipment availability. This was a prudent approach to take, given the uncertainty over a number of factual matters Ofcom itself identified:

> *"any potential problem could be addressed through future Ofcom regulatory decision over liberalisation of 1800MHz spectrum for LTE (at which point there may be better information over benefits of LTE and how it will be used)"* [45]

[43] Ibid Attachment 2 p.50, 26th January 2010, Guidance Paper to Ofcom's Policy Executive
[44] 5th April 2012 disclosure, Attachment 2, p.41, Internal Memo dated 7th January 2010
[45] Ofcom disclosure 5th April 2012, Attachment 2, p.35



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

*Ofcom must take a completely free standing decision on liberalisation*

The Commission did not have jurisdiction to consider liberalisation

102. It is clear from the CAT's judgment in *Telefónica vs Ofcom* that an authorisation process under Article 14 of the Authorisation Directive is the only process whereby the free-standing issue of any liberalisation decision for a particular licence (or class of licences) shall be made by the relevant national authority (Ofcom) on its merits within the context of the prevailing legal framework, specifically the duty to promote competition.

103. The duties of the competition authorities when exercising their powers under merger control, and the duties of Ofcom when exercising powers under the regulatory framework for electronic communications, are not the same. In particular, the duty of Ofcom to "*promote competition*" when undertaking *ex ante* regulatory intervention under the Common Regulatory Framework, goes beyond the duty of competition authorities to prevent impediments to or lessening of competition when exercising their powers under the merger control rules.

104. It follows that the Ofcom will not comply with its duties if it relies on the Commission having discharged this duty on its behalf. The Commission did not purport to (and could not) fetter Ofcom's discretion with regard to reaching a decision to liberalise licences under the prevailing national and Community Law. Any assessment by the Commission of the merits or otherwise of liberalisation, as distinct from its assessment of *prima facie* competition issues regarding spectrum holdings, would have been outside the scope of its competence.

105. We believe that Ofcom cannot reach a well-reasoned, proportionate and rational decision without undertaking its own detailed consideration of how competition should be promoted under the terms of the variation request and in light of the prevailing legal and factual matrix today. In order to discharge its free-standing duty (and to avoid impermissibly fettering its judgement in performing that duty), Ofcom is required to consult again on its own competition assessment, one which conforms to its obligations under the CRF and current national law. Ofcom cannot rely on a merger control undertaken in 2010 for these purposes.

The relevant legal instruments were not even drafted, so how could the Commission opine?

106. Even if the Commission (DG Competition) had had jurisdiction when acting in the merger context (which it did not), the relevant legal instruments regarding LTE liberalisation did not exist in March 2010[46], even in draft form. It was only in July 2010, that the Commission (DG

[46] The UMTS Decision (2009/766/EC) was made 16 October 2009, published in the OJ on 20 October 2009, and had an implementation deadline of 9 May 2010. The Mandate to CEPT to study the inclusion of LTE (and WiMAX) in the 900/1800MHz Decision was first discussed by the RSCOM in March 2009, adopted by the RSCOM in June 2009 and finalised in September 2009 after scrutiny by the EP. The ECC wrote to the RSCOM in March 2010 to say that the deadline requested in the Mandate could not be met because of the complexity of the studies and missing external information. **It was only in July 2010, the Commission stated its intention to update the annex of EC Decision 2009/776/EC on the 900/1800 MHz band to allow the use of LTE and WiMAX technologies in these bands, following the final adoption of the CEPT report envisaged in November 2010**. The LTE Decision was not, according to the public RSC documents, discussed before RSC#34 in December

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

Information Society) stated its intention to update the annex of EC Decision 2009/776/EC on the 900/1800 MHz band to allow the use of LTE and WiMAX technologies in these bands, following the final adoption of the CEPT report envisaged in November 2010.

107. We find it hard to understand how the Commission (or Ofcom) could have fully considered an issue without any view on the content of the enabling legislation.

108. Ofcom rightly chose to defer consideration of the issue of liberalisation. It now has the opportunity to address the free-standing issue of liberalisation in light of today's legal and factual matrix. This does not mean Ofcom cannot and should not take the Merger Decision into account, where it is relevant. What it means is that Ofcom is not bound to wave through liberalisation on the basis that the Decision decides every point of relevance, as it appears to be suggesting at §§4.17-4.18 of the Notice.

*Requirement to undertake a proper cost-benefit analysis*

109. We agree with Ofcom's assessment that, when undertaking the regulatory tasks specified under the Authorisation Directive, it must ensure that its principal duty is complied with, that is to "*further the interests of consumers, where appropriate by promoting competition.*"

110. We also note that Ofcom must assess whether a distortion of competition is created, given that risk is identified by Recital 14 of the 3G RSC Decision. In previous liberalisation processes, Ofcom has undertaken very thorough and detailed analyses ; and it has done so in order to discharge this same principal duty.

111. Ofcom has the tools at its disposal to properly assess whether the interests of consumers are served by creating monopoly LTE provider ahead of the availability of 800MHz /2600MHz spectrum from the Combined Award.

112. Just as in the 2G liberalisation process, the Cost-Benefit Analysis should be at the heart of the decision making, not just a "bureaucratic add-on"[47]. These benefits and costs must be properly quantified and the quantification consulted upon. Where benefits and costs cannot be quantified they must be clearly explained in detail, so that their relative importance can be properly assessed[48].

113. Telefónica requested a copy of Ofcom's Cost-Benefit Analysis ("CBA") under its FOIA request. Ofcom was unable to provide any documentary evidence that it had conducted such an analysis.

---

2010. The RSCOM agreed on a stable version of the revised EC Decision 2009/766/EC to include LTE in December 2010. The procedures to amend the Decision were finalised by the Commission in April 2011, including an RSC regulatory opinion by written procedure. The LTE Decision (2011/251/EU) is an amendment of Decision 2009/766/EC and was published in the OJ on 27 April 2011.

[47] http://stakeholders.ofcom.org.uk/binaries/consultations/better-policy-making/Better_Policy_Making.pdf §1.6 *"To be effective, the process of doing an Impact Assessment should begin right at the start of a project, with the Impact Assessment being developed from then onwards. An Impact Assessment should therefore be a core part of the policymaking process, not a bureaucratic add-on."*

[48] *Vodafone vs Ofcom* §124.



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

114. It is our view that the lack of a current CBA is a material procedural and substantive failing which invalidates the current process. A CBA is necessary for Ofcom's decision; and before Ofcom can rely on any CBA, that CBA must have been the subject of fair and full consultation.

*Procedural failure – lack of disclosure, insufficient transparency*

115. On 26th March, *The Times* published an article which stated:

> *"Three and Virgin Mobile have the right to launch 4G six months after Everything Everywhere's service goes live because of an agreement with the European Commission signed at the time of the Orange and T-Mobile merger."*

116. The substance of this article was confirmed by Mr David Dyson, CEO of Hutchison 3G UK Limited ("Hutchison") on 27th March at an industry conference. Telefónica is entirely unaware as to the scope, nature and duration of the entitlement to 4G wholesale provision by EE. Telefónica does not know, for instance, whether such entitlement last only until such time as the auction; or whether it may last beyond the auction (and if so, for what period).

117. This information was not in the public version of the Merger Decision and is not evaluated at all either in the Notice or in the consultation on the Combined Award. It appears from the 27th April disclosures, that some form of commercial wholesale 4G access agreement was reached between EE and Hutchison at the time of the merger. Telefónica cannot understand why Ofcom does not consider this state of affairs to be relevant; nor why Ofcom does not accept that all stakeholders would benefit from a clear understanding of this obligation and its market consequences (whether by publication of the agreement or a full summary of it) when forming a view on Ofcom's proposals, both:

    a. In relation to the Combined Award; the availability of a viable wholesale solution for the "fourth player" must be, at the very least, a relevant consideration when evaluating strategic incentives in the auction process; and

    b. When considering the strategic incentives and the future competitive landscape arising from early liberalisation, it must be relevant to consider all the potential actors which may already have a clear path to LTE ahead of the Combined Award.

118. Failure to disclose this relevant information and properly to consider it in both processes is a grave and self-evident procedural shortcoming. Even now, despite repeated requests from Telefónica in correspondence, Ofcom has failed to explain in any detail the basis upon which 4G wholesale access is to be granted or the role that the prospect of such access (if any) has played in its own or in the Commission's analysis. Somewhat remarkably, Ofcom's letter of 25th April 2012 contains the statement that Ofcom has *"no information on the nature or content"* of negotiations that it knows are on-going between Hutchison and EE about 4G wholesale access, indicating that Ofcom has not even asked to be provided with copies of or to be appraised or these arrangements. Yet we see in the 27th April 2012 disclosure that as early as 23rd November 2011, in its application for a variation where it highlights the

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

wholesale agreement with Hutchison, EE offered to provide Ofcom with *"any further information which you need".*

*No assessment of the likelihood of delay and the strategic risks created by these proposals*

119. In Ofcom's consultation document for the Combined Award[49], produced by the very same department within Ofcom and still subject to consultation at the time that the Notice was published, Ofcom set out its view that spectrum holdings and the existence of a clear path to LTE creates strategic incentives on existing licensees, such that *they are likely* to act in a way to foreclose strategic inputs to their competitors.

120. The pay-off for the strategic actor is a reduction in the intensity of competition. For this argument to hold in relation to the Combined Award, such that Ofcom can rely on it, the following must be true:

    a. Strategic behaviour of this sort (three players seek to foreclose one player) must be sufficiently likely to occur, i.e. the incentive effects must be large, the pay-off rewarding notwithstanding the costs and risks involved; and

    b. The potential negative effects on consumers of such strategic behaviour must be significant enough to warrant the distortion of an otherwise efficient auction process.

121. Clearly, given the proposition in the Combined Award consultation and Ofcom's desire to intervene with costly *ex ante* remedies, Ofcom must consider the incentive effects to be sufficiently large and the negative impact on consumers of input foreclosure on the fourth player to be similarly large.

122. Ofcom and Government have repeatedly highlighted that the process surrounding the Combined Award runs a substantial risk of litigation delay. This risk has been a long running-concern for both Ofcom and Government. For example:

> *"It has been very disappointing to witness the extent to which the incumbent mobile operators have chosen to entangle this process in litigation or threats of litigation. We recognise, of course, the need for companies to defend their commercial interests and to have recourse to the law in order to do so. If a regulator or any other public authority makes a decision that is either procedurally or substantively flawed, the right of appeal is there to ensure good decisions replace bad ones. But when litigation becomes essentially strategic rather than based on objective grounds, and when it has the effect of holding back innovation and hampering growth, it is legitimate to ask whether the overall legislative framework fully supports the public interest in this increasingly vital area."*[50]

[49] http://stakeholders.ofcom.org.uk/binaries/consultations/award-800mhz/summary/combined-award-2.pdf

[50] Ed Richards, CEO Ofcom, 29 November 2011 http://media.ofcom.org.uk/files/2011/12/SPECTRUM-POLICY-SPEECH-291111.pdf



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

> *"I hope therefore that there will be no further delay caused by any challenges from the mobile operators themselves."*[51]
>
> *"The right hon. Gentleman makes very valid points. This is an independent process that is run by Ofcom, but he is right to indicate that if mobile phone companies decide to litigate this process, as they have in the past, that will seriously hold it up and be of great detriment to the consumer."*[52]

123. As recently as 18th April 2012, Ofcom's CEO stated at a conference that he expected and was planning for the Combined Award decision to be litigated.

124. The risk of strategic behaviour by Everything Everywhere is raised as a substantive concern by Ofcom as early as October 2009, in its review of the proposed merger:

> *"is there a strategic incentive for the combined entity to block others from gaining spectrum in future auctions?"*[53]

125. Against this backdrop, we are therefore surprised and concerned that Ofcom conducts no analysis as to:

    a. whether the incentive effects of early liberalisation are likely to increase the risks of delay in the availability of competing spectrum inputs; and

    b. the sensitivity of its CBA to an extension of the Interim Period, as this will have a measurable impact on the costs of Ofcom's proposals.

126. Clearly, on point (b), Ofcom cannot undertake a sensitivity analysis on a CBA it hasn't produced in the first place. This compounds Ofcom's procedural failure.

127. We are at a loss to understand why Ofcom does not consider a monopoly wholesaler to have an even larger incentive to foreclose all its potential wholesale competitors for a substantial period? Further, if a wholesale agreement is reached with Hutchison (in respect of which Ofcom presently has "no information") or Virgin Mobile:

    a. If Hutchinson's wholesale entitlement is not time limited to run until the Combined Award (or a period thereafter) Ofcom would then need to re-evaluate the implications of spectrum risks and input foreclosure on Hutchison, with regard to the Combined Award;

    b. If Hutchinson's wholesale entitlement is time-limited or capped in some way by the taking place of the Combined Award, the existence of such wholesale entitlement may itself produce strategic litigation, by eliminating the main constraint on a challenge to the Combined Award by Hutchinson; and

[51] Ed Vaizey MP, Minister of State DCMS, 15 November 2011
http://www.dcms.gov.uk/news/ministers_speeches/8625.aspx
[52] Ed Vaizey MP, Hansard 3 November 2011
[53] 5th April disclosure, Attachment 1, p.31



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

c. Ofcom would then need to determine whether there were a larger number of actors that could give effect to input foreclosure through litigation.

128. If Ofcom does not consider such incentives to exist there can be no case made for any spectrum reservations in the Combined Award. There is a clear choice to be made here, a consistent position is required.

129. To use Ofcom's own hypothesis from the Combined Award:

a. The focus of strategic behaviour is clear[54]

i. there are 4G "haves" and "have nots" that are readily identifiable;

ii. the "have nots" are left with only two routes to retain their competitiveness, namely through obtaining the required spectrum in the Combined Award or in the divestment/private sale process[55]; and

b. There are a number of parties that alone or in concert could bring about this strategic foreclosure[56]; and

c. The costs of such foreclosure to the "haves", i.e. legal costs, are low relative to the rewards such that any one of the "haves" will have the incentive to act alone, even if there is free-riding by the others[57].

130. Indeed, it is evident that at least one of the potential beneficiaries of mandated wholesale access (Hutchison) is already forming an orderly queue outside the law courts.[58] EE itself appears to be factoring in the risk of litigation into its plans[59]. Whilst it would be inappropriate to comment on their motives, the effect of such proposed challenges would be to extend the monopoly of Everything Everywhere until those challenges had been resolved, to the detriment of consumers.

131. In order for any decision with regard to this Notice to be rational, Ofcom must consider these strategic incentives and consult on that consideration. Its position must be consistent with any Decision made on the Combined Award, to the extent that Ofcom relies on strategic incentives and behaviour in that Decision.

132. Having properly considered the risks and likelihood of this strategic behaviour arising, Ofcom must then:

[54] Combined Award consultation Annex 6 §5.147

[55] We note that the creation of a second wholesaler does not help Ofcom, because there are still incentives for two to foreclose two.

[56] Combined Award consultation Annex 6 §6.58

[57] Ibid §§5.57-5.61

[58] http://www.guardian.co.uk/business/2012/mar/26/3-legal-action-4g-auction

[59] http://www.bloomberg.com/news/2012-02-23/everything-everywhere-to-become-first-u-k-carrier-to-offer-4g.html "They have to take into account the competition consequences," said Kip Meek, who advises Everything Everywhere and who formerly worked for Ofcom. "If they do it poorly then they will be litigated."

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

a. Factor that into the CBA that it is required to produce, in order to properly consider the sensitivity of net benefits (losses) to consumers; and

b. Take due account of this risks when considering remedies.

133. Telefónica has, in the interests of a timely resolution, undertaken a preliminary assessment which forms part of this consultation response in Part 6 below.

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

# 5. A competition assessment using today's factual matrix

*Creating a monopoly provider would be unlawful*

Ofcom believes there to be a bifurcation risk and has been willing to intervene *ex ante* to prevent it

134. In its 2009 2G liberalisation consultation, Ofcom developed its hypothesis of competitive harm caused by liberalisation into the hands of a limited number of market players. It suggested that the mobile market might bifurcate between those operators able to offer "high quality data services" and those which could not. See for example:

> *"Competition effects may arise where the quality of mobile broadband services is sufficiently important and cost differences between different spectrum bands prevent operators without low frequency spectrum from matching quality, with the implication that fewer players can afford to compete in the provision of high quality mobile broadband services."* [60]

135. Again, in the 2011 consultation on the Combined Award[61] Ofcom develops the hypothesis further:

> *"In particular, we focus on the possible emergence of markets that require higher quality data services that are not constrained by lower quality data services.*
>
> - *A high quality market associated with reliable indoor coverage for data services. This could occur if low quality products (with poor indoor coverage) did not constrain the price of high quality products as consumers were not prepared to switch to low quality products. This might affect our competition assessment if reliable indoor coverage were only possible with access to sub 1GHz spectrum and if not all providers had access to sub 1GHz spectrum. This could have implications for all mobile services, if consumers tended to buy bundled offering that included access, voice and data. The three candidate markets for higher quality data services that we consider most likely to emerge are:*
> - *A separate market associated with higher data speeds and better latency (delivered by LTE) which is distinct from a market associated with lower data speeds (delivered by 2G and 3G). It is possible that services delivered with large contiguous spectrum blocks using LTE are able to offer such superior quality that there is a break in the chain of substitution between low data speed services and higher speed services. This could affect our competition assessment if only some providers had access to large contiguous bandwidths of spectrum that could be used*

[60] 13 February 2009 Consultation, §4.48
[61] Combined Award consultation March 2011 Annex 6 §3.30

*for LTE. Again, this could have implications for all mobile services if services tend to be bought in bundles.*

- *A division of the retail market into services that had priority over other services (e.g. a highly reliable business service compared to a lower priority consumer service). The use of LTE technology may make such segmentation easier to do. For there to be separate markets, there would need to be only a weak degree of substitution between the two types of service.*

*We recognise that it is not possible to know for sure whether such markets may develop. Our assessment is very forward looking and there are currently no services provided using LTE in the UK. While there is evidence that consumers currently value quality of service, and it seems very plausible that they would place higher value on data services that offered higher quality services, it is less clear this would mean that the higher quality services would be unconstrained by the lower quality services.*

*However, we consider it is possible that separate retail mobile markets may develop in the future, which might be accompanied by separate markets at the wholesale level. If not all providers were able to access some retail markets, this could impact on our competition assessment.*"

136. In the 2011 Consultation the very risk that bifurcation might occur, even though it was uncertain, was sufficient to justify *ex ante* intervention in the Combined Auction.

137. Indeed the risk of market bifurcation is relied on by the Commission in the Merger Decision in March 2010, a Decision to which Ofcom appears to attach great weight[62].

*"This could result in a bifurcation of the market in the years to come, with the JV being the only MNO in the UK able to offer LTE technology at the best possible speeds with full coverage and with the remaining MNOs offering a much inferior product.*"

138. As recently as the January 2012 Combined Award consultation, Ofcom still believes there is a risk of bifurcation, although it is now uncertain whether that will arise in practice. The risk remains, however, in Ofcom's view[63].

*"We consider that it is possible that separate markets may develop for the provision of one or more segments of mobile services or customers – as discussed in the March 2011 consultation, possibilities include a separate high quality data market associated with reliable indoor coverage or a separate market associated with higher data speeds and better latency delivered by LTE. For this to happen, the*

[62] Merger Decision §121
[63] Combined Award January 2012 consultation Annex 6 §2.29



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

*prices in the segment would have to be insufficiently constrained by the main mobile market*"

139. Again, an uncertain risk of bifurcation still warrants *ex ante* intervention in the auction. Ofcom has to be consistent, it cannot on the one hand see a risk and intervene *ex ante* to prevent it, then a few weeks later propose to create the very same conditions but not intervene *ex ante*, without properly quantifying and analysis costs and benefits.

140. The potential for market bifurcation is clearly a highly relevant issue, Ofcom has expended extensive time and effort in pursuing it over the last five years. It remains a relevant consideration and a risk; Ofcom says so in terms as recently as January 2012. Yet Ofcom undertakes no analysis of that risk with regards to the specific situation of early monopoly LTE1800 liberalisation for EE. In particular, Ofcom does not properly assess whether the specific market conditions, at the time EE's monopoly on LTE is granted, will leave prices insufficiently constrained by the broader mobile market[64]. Ofcom has undertaken no research as to whether EE would be constrained by the market and whether consumers would be willing to pay 5-10% more for 4G mobile broadband. Ofcom has not sought the relevant information from EE, even though it has the statutory powers at its disposal.

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

<u>HSPA+ is not a supply-side substitute for LTE in the short term, increasing bifurcation risks</u>

141. In the January 2012 Combined Award consultation Ofcom seeks to rely on HSPA+ providing a competitive constraint to LTE, at least in the short term[65]:

> *"Telefónica and Vodafone's existing holdings are likely to be sufficient for them to be credible in the near term, for at least as long as HSPA900 is competitive with LTE, but there is some potential risk of them not being credible in the longer term if LTE900 equipment is not available soon thereafter, or because of the relatively limited overall spectrum share they would hold if they did not win spectrum in the auction;"*

142. Again, in the Notice, Ofcom views implementation of HSPA+ as a factor which might reduce competitive distortions and consumer harm[66].

143. Critically, Ofcom is addressing HSPA+ in the abstract, relying on the performance quoted by its proponents. In reality, HSPA+ deployments will be made into 3G networks already awash with traffic from non-HSPA+ devices. By contrast, the LTE1800 deployment of EE will be into empty spectrum. This difference magnifies performance differences, rather than making HSPA+ more likely to be competitive with LTE.

---

[64] Ibid footnote 16 to Annex 6 §2.29 *"With the hypothetical monopolist test, a service is considered to be in a separate market if a hypothetical monopoly supplier could impose a small but significant, non-transitory increase in price ("SSNIP") above the competitive level without losing sales to such a degree as to make this unprofitable. If such a price rise would be unprofitable the market definition should be expanded to include the substitute services. The OFT Guidelines on Market Definition normally considers a price five to ten per cent above competitive levels to be 'small but significant'."*

[65] Combined Award consultation January 2012 Annex 6 §4.2 bullet 2

[66] Notice §6.4 bullet 2

144. Information from Telefónica UK's testing of all five UK 3G networks and our trial of 4G clearly illustrate the point.

145. The following table provides performance data of HSPA+ (CAT14 devices) in live 3G networks today[67]. The vast majority of the traffic is being generated by older 3G devices, for example, in the O2 network, only 5% of active devices are HSPA+ compatible. The experienced average HSPA+ downlink bit rates (using CAT14 devices) are typically around [✂].

**Figure 1 : UK HSPA+ network deployment under loaded "live" conditions**

[✂]

146. Telefónica is running a trial (i.e. unloaded) 2x20MHz 4G network in London. The performance of this network will provide a first approximation to the performance of EE's 2x20MHz LTE1800 network at launch. The tests were undertaken by an independent third party (Qualcomm).

**Figure 2 : Unloaded LTE network performance**

[✂]

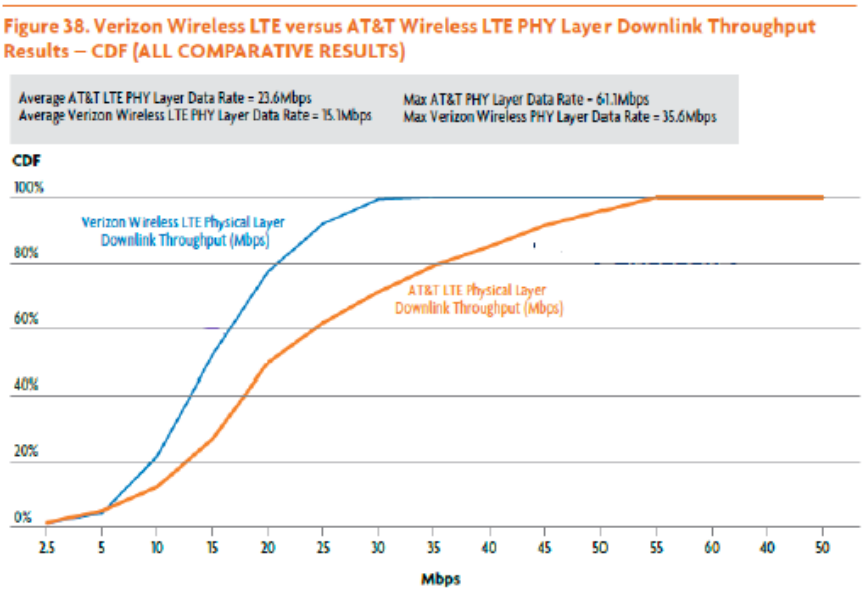
147. These data show the LTE CAT3 device user peak rates are close to [✂]Mbps in the downlink and [✂]Mbps in the uplink were experienced, with typical user far cell/mid cell downlink bit rates ranging from [✂]Mbps.

148. Recent results from Verizon and AT&T's LTE700 (2x10MHz bandwidth) networks in the US show users are expecting peak rates of around 30-55Mbps and average rates of 15-20Mbps. In a 2x20MHz bandwidth LTE1800/LTE2600 system we could therefore expect average rates of twice this at 30-40Mbps.

[67] March 2012 benchmark testing undertaken by Telefónica across all four UK 3G networks.

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

Figure 3 : Commercial LTE networks – ie the situation for EE at launch




*[Ref. Signals Ahead, "Mother of all Network Benchmark Tests", September 2011, Page 60, Fig. 38]*

149. It is our strong view that, in the consultations on the Notice and the Combined Award, Ofcom has not properly assessed the performance differences between EE's LTE network at launch and the performance of loaded HSPA+ networks operated by the remaining "national wholesalers". Therefore, Ofcom cannot have properly assessed the risk of bifurcation, because it has not taken an informed view on whether mature loaded HSPA+ networks would place any competitive constraint (i.e. constrain the monopolistic pricing behaviour) of a new LTE network offering over 10x the average throughput.

150. We are strongly of the view that this differential in quality will lead to a bifurcation of the mobile market, until competing LTE services are available nationally. Ofcom needs to properly assess whether this would become an entrenched position, in light of the concerns it raised at the time of the merger.

151. EE will be planning its 4G launch now, yet Ofcom has undertaken no evidence gathering as to whether EE plans to charge above the market price for 3G based data services or to tie customers for such service in to longer contracts. Essentially, Ofcom has failed to determine whether EE itself believes that it will be able to make supernormal profits during the "Interim Period" described in the Notice.

152. Ofcom will be granting EE an arbitrary monopoly in breach of its obligations under Article 8.2 of the Framework Directive. Ofcom has a duty to promote competition, not to create monopolies, even temporary ones. This arbitrary advantage does not arise because of any innovation or R&D on the part of EE - EE has not negotiated a commercial exclusivity (as with, say a device manufacturer in relation to a new product). The monopoly would be

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

based on the accident of historical licensing decisions and the happenstance of available LTE handsets.

153. Ofcom needs to evaluate the risk of market bifurcation properly and reach a definitive view on market bifurcation. At this point we should note that there are no parallels with Ofcom's decision regarding U900, where the same technology (3G) was liberalised to complement existing 3G deployments on other networks. The extent of performance differences between U900 and U2100 were demonstrated to be marginal and not sufficient to bifurcate the market[68].

154. A bifurcated market would imply the creation of SMP. It would be unlawful for Ofcom to generate SMP through its own decisions. Ofcom's own arguments regarding the strategic incentives to reduce competitive intensity support the view that the monopoly LTE provider would be able to set prices in a manner unconstrained by competitive pressure and/or to accrue a long lasting competitive advantage that resulted in higher aggregate prices by consumers tied into to lengthy contracts. This cannot be in the consumer interest.

*What factual matters have changed since March 2010?*

155. The following table pulls out a range of factors that must be relevant to any consideration of the implications of liberalisation (whether by the Commission in the March 2010 Merger Decision, if contrary to Telefónica's view the Commission did consider these matters, or by Ofcom in due course in the new consultation which we trust Ofcom will undertake).

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

[68] Advice to Government http://stakeholders.ofcom.org.uk/binaries/consultations/spectrumlib/annexes/government-advice.pdf §5.35 *"Vodafone and O2 may have a small speed advantage in more challenging conditions – relatively deep inside buildings further from the base station – with a larger advantage in the very hardest-to-serve places. However, in many easier to serve indoor locations liberalisation of 900 MHz for UMTS would result in little or no advantage to O2 or Vodafone."*

§5.39 *"On balance, our view is that the liberalisation of 900 MHz for UMTS is unlikely to result in such a material unmatchable advantage for Vodafone and O2 that it could be regarded as distorting competition. This is because any throughput advantage is likely be modest in most locations."*

**Figure 4 : Factual and legal terrain, comparative analysis between March 2010 and May 2012**

| | **March 2010** | **May 2012** | **Implication** |
|---|---|---|---|
| The competitive advantage accrued by sub-1GHz cf. 1800MHz | Sub-1GHz spectrum is vastly superior to 1800MHz, see 2007, 2009 and 2011 consultations. | Ofcom now supports the view that 1800MHz deployed on a large cell grid is competitive with 800MHz, see Combined Award consultation [§4.28] | LTE1800 is highly attractive on a standalone basis and does not rely on any other inputs to be effective. |
| LTE is not a focus of the JV | [§133] the Parties submit that the absence of any mention of LTE in the documentation shows that it is not the rationale for the merger. | As early as September 2010, just six months following the Merger Decision, "LTE is on the roadmap"[69]. | It very quickly became a focus for the JV, as LTE was planned in at the start of its network consolidation / refresh. |
| Clearing spectrum for divestment (and also for EE's own LTE use, by implication) is difficult and time consuming. | [§§229-231]<br>This is further emphasised in EE's response to the March 2011 consultation on the Combined Award[70]. EE predicted that it would not be able to launch a comparable service to the divestment holder, ie an LTE1800 service before end 2013. | For some reason, EE in November 2011, just five months later[71], puts in its licence variation request, with a view to service launch in Q4 2012.<br>It is unclear to us, short of a catastrophic drop in network traffic, how this position is compatible with EE's previous submissions to the Commission and Ofcom. | The timing of spectrum availability is different from that assumed in the Merger Decision, if that is relevant. |

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

[69] EE Investor Presentation 28 September 2010 slide 66 *"LTE capability being introduced as part of the 2G modernisation"*

[70] http://stakeholders.ofcom.org.uk/binaries/consultations/combined-award/responses/Everything_Everywhere.pdf p.35-p.36 dated 13 June 2011 *"The counter-intuitive consequence of the above is that whoever acquires Everything Everywhere's divested 1800MHz spectrum will be better placed to introduce an 1800 LTE service than Everything Everywhere itself. The acquirer will be able to introduce a 2x10MHz LTE service from the end of 2013".*

[71] 23 November 2011

*Ofcom must undertake its obligations based on today's factual matrix, not the Commission's view on March 2010's factual matrix*

156. Hindsight is a wonderful thing. As it turns out, clearing the 1800MHz spectrum was much easier than the Merger Parties predicted. LTE was a focus of the JV[72] and became a focus just months after the merger was cleared, notwithstanding the lack of discussion and documentation of the 4G opportunity in the process leading up to the merger. By 2012 LTE1800 is a viable proposition. There are already LTE1800 devices on the market.

157. Ofcom has now stated the following are important considerations that need to be taken into account in any liberalisation decision:

    a. Whether HSPA+ is a viable competitive alternative to LTE in the short-term?[73] We have shown that HSPA+ in a loaded network is not competitive with LTE in an empty network, such that it does not form a realistic competitive response or a constraint on EE's pricing behaviour (whether at the retail or wholesale level);

    b. In order to compete with an LTE1800 operator a competitor would need to have both 800MHz and 2600MHz[74]. The Combined Award does not guarantee that outcome - it does not with certainty secure four players with either 1800MHz or 800MHz AND 2600MHz;

    c. Four national LTE wholesalers must emerge from the Combined Award and divestment process.

158. Therefore, we expect Ofcom to re-consult on a properly quantified Cost-Benefit Analysis, one which weighs the benefits and costs objectively and transparently. It must take account of the factual matrix today. It must consider issues that must be dealt with consistently across this decision and the decision on the Combined Award. Even if the Commission had considered the issue of liberalisation (and we have clearly shown that it did not), it could not be rational for Ofcom to follow the Commission's decision when what was predicted at the time (e.g. in relation to spectrum clearance) has not been borne out by the subsequent events.

159. In the interests of a timely decision and to properly inform the debate, Telefónica has undertaken a preliminary CBA in lieu of one being provided in this consultation. We expect Ofcom to consult on its own CBA, in due course.

[72] 28 September 2010 EE Investor Day documentation : *"Class-leading market offer to launch on 5th October: Orange and T-Mobile customers to access two national networks at no extra cost, as first phase of multi-network strategy to combine 2G, 3G, 4G, fixed broadband and WiFi in unique customer offer"*

[73] See Notice §6.4 bullet 2

[74] See Notice §5.10 *"Despite these differences, we consider it likely that, viewed in the round, an operator that holds a combination of 800 MHz and 2.6 GHz spectrum will be able to compete effectively with an operator with 1800 MHz spectrum."* [our emphasis]



Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

# 6. Cost benefit analysis

*Ofcom has to assume monopoly rents will be charged*

160. We have shown that HSPA+ deployed in today's 3G networks is not a credible substitute for 4G deployed in an empty network. If Ofcom still believes that HSPA+ is a credible substitute for 4G then it must revisit whether Hutchison will still be on the same market as other operators, should it fail to gain any LTE spectrum in the Combined Award. We will leave Ofcom to decide which policy outcome it wishes to maintain and which it wishes to undermine.

161. The market will bifurcate, as outlined by the Commission and Ofcom, following the launch of LTE1800 services.

162. It is Ofcom's stated view that reductions in competitive intensity will lead to higher prices for consumers.[75]

> *"Strategic investment, if successful, can be expected to affect strategic investors' profits through changes in the retail prices charged and/or in the volume sold to consumers or other reduced costs as a result of less competition (such as lower investment in quality or innovation). Strategic investors that are successful are indeed likely to set higher retail prices than would otherwise be the case, exploiting the reduced level of competition following the foreclosure of the victim."*

163. If Ofcom does not believe that a monopoly provider of 4G will charge monopoly rents (whether at the wholesale or retail level) then it must dispense with the pretext for *ex ante* intervention in the Combined Award, in the form of the reservation for Hutchison. We will leave Ofcom to decide which policy outcome it wishes to maintain and which it wishes to undermine.

164. In our assessment we shall assume that the monopolist, unconstrained by competitive pressure, executes a significant non-transitory increase in price of between 5-10%, as envisaged in the SSNIP test. That is a legitimate assumption in light of the non-substitutability (which we have demonstrated) of HSPA+ in established 3G networks with an empty 4G network.

165. Everything Everywhere's current contract ARPU[76] is £32.90pcm. A 5-10% monopoly rent on the average customer, over a 24 month contract at a social discount rate of 3.5%, equates to an NPV of monopoly rents of between £38-£76 per annum per customer (averaged across EE's net additions). We view this as a very conservative estimate, as it reflects the average value of EE's customer base, not the high value customers that it would seek to attract and lock-in during the period of its monopoly.

[75] Combined Award consultation Annex 6, §5.135
[76] Average monthly Revenue Per User

166. If Ofcom believes that lower competitive intensity leads to higher prices for consumers, it must clearly explain to consumers why it is willing to make a decision which will lead to consumers paying monopoly rents of the order of £75 per annum.

*Exclusivity has long term effects*

167. The negotiation of commercial exclusivity (such as Telefónica's former exclusivity with the iPhone) is a totally legitimate commercial exercise; as is investing in research and development to innovate with an exclusive product. By contrast, the gifting of a statutory monopoly to an undertaking which (by historical accident) enjoys an allocation in a particular frequency band is not a legitimate basis from which to secure exclusivity.

168. Telefónica UK's experience of iPhone exclusivity between 2007 and 2009 is instructive when trying to estimate the impact of exclusivity. For the last five quarters of the exclusivity period, Telefónica put substantial handset subsidy into the proposition including an entry level "free at" price point. This led to a [✂] increase, in absolute terms, in Telefónica's share of net additions in the market. That was at a time when only [✂] of our customer base was using a smartphone. The position today is very different. In 2013 we estimate that [✂] of our base will have a smartphone. The effect of 4G exclusivity needs to be scaled accordingly.

*Significant consumer harm*

169. Scaling the exclusivity effect and using the monopoly rents identified above we have estimated the quantum of consumer harm caused by:

    a. A monopoly period extending to the earliest date that national 4G services will be available from competitors (1Q 2014, assuming no strategic delay to the Combined Auction through litigation); and

    b. The negative impact on consumers of delay to the auction and the availability of competitive inputs.

170. The minimum consumer detriment is [✂]. Each quarter's delay to the auction would equate to a further [✂] per quarter of incremental detriment. A delay of one year in 4G launch by competitors could, in total, cost consumers between [✂] in monopoly rents. Telefónica has supplied Ofcom with a detailed model from which these figures are derived.

171. By contrast, delaying the start of the monopoly period significantly reduces both the risks of enduring monopoly rents following delay of the auction; and the quantum of the impact.

    a. Liberalisation conditional on four players having a clear path to LTE by 1Q 2014, would reduce the detriment to zero;

    b. Liberalisation in Q3 2013 would still leave a duopoly (i.e. between EE and whichever operator acquires EE's divestment spectrum) but may also reduce the scale of the negative effects towards the lower bound of the calculated range [✂].

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

172. The figures above suggest to us that some parties will have substantial commercial incentives to delay the auction, arising from Ofcom's own proposals to create a monopoly that is detrimental to the interests of consumers.

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

# 7. Remedies

*The remedy in the merger decision*

173. It is clear from the Merger Decision that the divestment remedy is used to address a structural issue, not the issues of liberalisation and timing. However, for completeness, we engage first on the issue of remedies under the proposition made by Ofcom and Everything Everywhere, that is that the divestment remedy is also the remedy envisaged by the Commission and Ofcom, at March 2010, as dealing with any negative competitive effects caused by liberalisation.

174. Ofcom's internal documents state, in terms, that for the divestment to be an effective remedy, any LTE1800 launch by EE must be on the market within a short timeframe of the launch by the divestment holder. It follows therefore, that on Ofcom's own argued case, and that of EE, that the earliest Ofcom could lawfully authorise the use of LTE1800 by EE would be 30th September 2013 – the earliest date the divestment holder will have access to its spectrum.

175. Liberalisation from this date is the only conclusion that, on Ofcom's own case, would allow it to comply with Article 21 of the EC Merger Regulations.

176. We assume Ofcom and EE will reflect on whether, in light of the disclosures of Ofcom's own internal documents, it was wise to characterise the Merger Decision in this way. If Ofcom decides to stick with this characterisation then, any conclusion on timing other than 30 September 2013 will require a clear explanation and substantial supporting contemporaneous evidence (that Ofcom would have failed to disclose under FOIA).

*Determining the most proportionate remedy, consistent with Ofcom's stated policies*

177. There appear to be a number of possible remedies as identified by Ofcom at Section 6 of the Notice. We take this as our starting point when considering what remedies Ofcom should evaluate in its re-consultation. There appear to be two viable options:

    a. Delay liberalisation until there is sufficient competitive constraint of EE; or

    b. Regulated Access.

178. Delaying liberalisation implies that liberalisation is something that could be granted now, yet on Ofcom's own argument and evidence, liberalisation for EE cannot be allowed until 30 September 2013. If Ofcom were to re-consult on liberalisation and timing as a free-standing issue then it would need to make a case for the timing of liberalisation in light of:

    a. The factual and legal matrix that we see in the market today; and

    b. Its stated policy of securing four national wholesalers. In particular, we note that Ofcom does not view LTE2600 as sufficient to compete with LTE1800 based networks.

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

179. We look forward to Ofcom's proposals on the appropriate timing of liberalisation in its re-consultation.

*Could Regulated Access be used as an interim measure that would allow earlier liberalisation?*

180. Ofcom rightly recognise at §6.9 of the Notice that one option to address competitive distortions caused by a variation of EE's licence could be to impose regulated wholesale access on EE as a condition of liberalisation. Ofcom notes that the advantage of wholesale access is that '*more competitors could potentially provide services similar to those that could be provided using LTE by EE*' (§6.10).

181. Ofcom proceed nonetheless to rule out regulated access on the basis that:

    a. There are a challenges associated in designing and implementing a wholesale access regime, because the commercial interests of the parties are unlikely to be aligned (§6.11). In particular, EE would be unlikely to have a real incentive to give access on acceptable terms, because (among other things) it would be likely to be focused on the technical and commercial challenges of its own requirements.

    b. EE might seek to frustrate access at an operational level (§6.12).

    c. Although it is possible to address these challenges, this '*would take a potentially length period of time*', such that in practice '*imposing regulated access would be unlikely to increase the number of competitors with access to LTE 1800 during the Interim Period*' (§6.13).

    d. There would be a risk of regulatory failure in imposing regulated access (§6.14).

    e. In light of these factors regulated access would not be an appropriate and temporary measure to address competitive distortions (§6.15).

182. However, it became clear, following disclosure in The Times newspaper that at least one MNO already has the option of wholesale access for LTE. Telefónica fails to understand why Ofcom did not consider the prospect of provision of wholesale access as a relevant matter to be considered both in the context of this Notice and with regard to its purported four player policy in the Combined Award. Ofcom was fully aware of this commercial arrangement as early as the completion of the merger and no later than EE's application for the licence variation in November 2011.

183. This revelation in our view fundamentally undermines Ofcom's reasoning for ruling out regulated access (which we have summarised above). We agree with Ofcom that a wholesale access obligation created by regulation can be difficult and time consuming to design and implement (§6.11). However:

    a. A key premise of Ofcom's logic (namely that the interests of the parties would not be aligned) is falsified by the fact, which Ofcom knew but did not even mention, that such

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK

access was being freely commercially negotiated by EE. That suggests (a) that EE may be able to grant access on acceptable terms, (b) that EE is not so focused on operational issues as to be unable to focus on access and (c) that the risk of operational frustration by EE can (at least from the perspective of EE's counterparties) be overcome.

b. Moreover, any existing commercial arrangement between Hutchison and EE means that there is already a template of a viable wholesale offer that could be made available as an essential facility to all MNOs on a non-discriminatory basis, making the process of regulatory design much simpler than envisaged by Ofcom.

184. Conclusion of a wholesale arrangement between Hutchison and EE is also likely to ensure that monopoly rents are not just transferred from the retail level to the wholesale level. If a commercial wholesale agreement is made, we would expect Hutchison to drive a hard bargain in securing its wholesale deal. Wholesale access is a real cash cost to a company struggling to remain profitable.

185. Hutchison's informal response to this consultation[77] suggests that no satisfactory commercial arrangement has yet been concluded. If it proves that commercial negotiations on wholesale access do fail, that may well show we that the monopolist is indeed seeking to maintain its monopoly rents by setting high wholesale prices – but in any event it must be a highly material consideration in Ofcom's reasoning as to the alignment of commercial incentives and the feasibility of imposed access.

186. So long as it is proposed to create a temporary monopoly in EE's favour, Ofcom must fully re-evaluate the appropriateness of requiring wholesale access as a remedy to the competitive distortions that monopoly would cause. At present, by failing to have regard to let alone consult upon the prospect of negotiated wholesale access, we consider that Ofcom's reasoning on remedies is both irrational and fundamentally unfair.

187. Conversely, any finding that EE had in fact frustrated an existing regulatory or commercial right of wholesale access such that it had not concluded acceptable terms with Hutchinson is clear proof of the strength and value to EE of the wholesale and retail monopolies in LTE; and thus proof (or a strong pointer requiring further quantitative investigation) of the consumer detriment modelled by Telefónica above. Far from showing no regulatory intervention is required, it shows that stronger regulatory intervention is required, either by refusing to liberalise until such time as EE has put in viable and open to all LTE wholesale arrangements, or by delaying liberalisation until sufficient competitive national LTE competition is on the market.

[77] http://www.techweekeurope.co.uk/news/everything-everywhere-4g-lobbying-75557

Telefónica UK Limited Registered in England & Wales no. 1743099 Registered Office: 260 Bath Road Slough Berkshire SL1 4DX UK