IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1238/3/3/15

Victoria House,
Bloomsbury Place,
London WC1A 2EB

9 December 2015

Before:

ANDREW LENON QC
(Chairman)
WILLIAM ALLAN
PROFESSOR COLIN MAYER

(Sitting as a Tribunal in England and Wales)

BETWEEN:

BRITISH TELECOMMUNICATIONS PLC — Appellant

- and -

OFFICE OF COMMUNICATIONS — Respondent

- and -

SKY UK LIMITED
TALKTALK TELECOM GROUP PLC — Interveners

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HEARING - DAY ONE

A P P E A R AN C E S

Mr. Rhodri Thompson QC and Mr. Nicholas Gibson (instructed by BT Legal) appeared on behalf of the Appellant (British Telecommunications Plc).

Mr. Josh Holmes and Mr. Tristan Jones (instructed by Ofcom) appeared on behalf of the Respondent.

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Wednesday, 9 December 2015

(10.30 am)

Housekeeping

MR.THOMPSON: Good morning, sir. Good morning, gentlemen. My name is Thompson, I appear from British Telecoms with Mr. Gibson and Ms. Davies and Mr. Holmes and Mr. Jones appear for Ofcom.

By way of preliminaries there has been some to-ing and fro-ing on the bundles but I think that a way forward has been reached. I don't know if they are causing the Tribunal any concern, but I hope that we can move forward in a reasonably convenient way. I think the main issue that has arisen is that originally the BT bundles were presented to a substantial degree in electronic form, but I think it has been agreed that Ofcom, insofar as they wish to refer to specific documents, will produce hard copies. I don't know if that is convenient for the Tribunal, but that is the way we are proposing to proceed at the moment.

THE CHAIRMAN: We have hearing bundles. I am not aware that there is anything missing from those, but if there is, no doubt that can be dealt with.

MR.THOMPSON: Fine, well I think there has been some supplementation of those bundles over the past few days.

In relation to timing, I think there was an indication from Ofcom that the timing may go shorter rather than longer, but I don't imagine that will cause any difficulties to anyone. At the moment I am working on the basis that today will be submissions and then we will move into evidence tomorrow, and then in terms of timing, we will have to keep that under review as we go along, but at the moment I am not seeing a problem about that.

THE CHAIRMAN: It did strike us that the timetable is on the generous side and, in particular, we wonder whether the last two days might be merged, the final submissions, but, as you say, we can keep that under review.

MR.THOMPSON: I don't think there is any problem about the outer bounds of the hearing, I think it is more likely to come forward than go back.

Thirdly, just by way of update, the Tribunal is aware that there is a parallel CMA process, at the moment in a virtual stage, which is perhaps apt in this case, and there was a CMC last Friday, just to talk about timetabling. We are assuming that that process will begin in earnest some time in the new year but, I don't think, again, there is anything that need cause the Tribunal any concern, so that is just by way of information.

Opening submissions by MR. THOMPSON

MR. THOMPSON: Moving to the substance of this morning, and just by way of overview of our case, we say that there are in substance six categories of reason why the decision in this case is invalid. First of all, it is wrong in principle, and that is the points that we raise at paragraphs 8 to 23 of our skeleton argument and, as it were, forms the background to the whole of Ground 1, which is before the Tribunal.

Secondly, it is wrong in law, which is the substance of Ground 1(B) and, to a degree Ground 1(C) and (D), which appears at paragraph 24 to 52 of our skeleton argument.

Thirdly, that it is unsubstantiated in fact, which is the main point under Ground 1(A), but also appears under Ground 1(C) and to a degree Ground 1(D), and that's at paragraphs 53 to 73 of our skeleton argument, so those are the three issues before the Tribunal in this hearing.

Then the fourth, fifth and sixth issues are the CMA points: first of all, that it fails to take utmost account of the views of the EU Commission in its comments on the draft decision, and just as a reference, that is paragraphs 47 to 58 of the amended notice of appeal.

Fifthly, it is legally uncertain and badly designed, that's Grounds 3 to 6, pages 58 to 107 of the amended notice of appeal, and then -- this is not a separate ground as such, but it is a point that we make at paragraph 6 of the amended notice of appeal and appears in a number of the places in the witness evidence, we say that it is a perverse decision in its likely regulatory impact, and that is a matter which the BT witnesses deposed to, and I don't know to what extent that is a matter that will be ventilated in evidence.

Just by way of overview, this hearing is concerned only with the first three points, as structured in our skeleton argument, but we say it is important for the Tribunal to bear issues 4 to 6 in mind as well when considering those first three issues, particularly insofar as appears to be the case, Ofcom suggests that BT's arguments under this ground are technical.

One should also bear in mind, by way of background, that although the CMA has the primary role in determining these other issues, all aspects of the appeal remain ultimately under the supervisory control of the Tribunal.

The Tribunal will also be aware, from reading the pleadings and the evidence, that BT feels strongly about these other issues and about the manner in which Ofcom has, in substance, chosen to intervene in the highly competitive retail market in a way that in BT's view, favours Sky and disadvantages BT, and that appears perhaps most clearly at paragraph 35 of Mr. Petter's evidence, which is at bundle II/1/10.

This morning what I was proposing to do was to structure my opening submissions into

three broad areas: first, some salient facts, which I think I have classified under ten headings; secondly, some general comments on Ofcom's position, and then thirdly, and this is the most substantial part of my submissions, I will address the three key issues under section 88(1)(a), the issue of risk, relevant risk or prospective risk, as it appears in the skeletons.

Secondly, the nature of the market analysis that is required for the purposes of this exercise.

Thirdly, the nature of the margin squeeze that must be the subject of the analysis and risk.

So those are the three topics that I will touch on.

First of all, issues of fact, and the first, and perhaps most important background fact which appears in various forms in the argument, is that the UK wholesale broadband market includes both standard broadband and superfast broadband, and that is an issue that is discussed by Mr. Murray at paragraphs 17 to 20 of his witness statement, which is at bundle II/5/5 to 6. I don't think we need to look at that because Mr. Murray will, no doubt, give evidence on this in due course, but the specific issue which is referred to in BT's pleadings, for example, at paragraph 14 of the amended notice of appeal, is the finding of Ofcom itself, which appears in the factual bundles, bundle III, part II, I think it is, tab 7. The primarily relevant paragraph I think is at 3.71 but it might be worth going back a bit in the analysis.

Ofcom is considering, from 3.40 onwards, at page 35 of the clip, its conclusions on the market analysis, and in particular at 3.40, towards the end:

> "We then consider other evidence on the substitutability of SFBB and SBB and in particular the extent to which SFBB is a must-have."

So they are looking at whether they are substitutable.

Then at 3.56 and following, under the heading "SFBB is not a must-have", and in particular, I would refer the Tribunal to the second sentence where Ofcom finds:

> "As in the 2010 WBA statement, it remains the case that the majority of broadband users do not require SFBB."

So they treat it as a not must-have product.

Then at 3.62, there is reference to the uptake of SFBB, and then the conclusion at the end is:

> "Take-up to date does not clearly indicate a need to move to SFBB or a lack of constraint from CGA."

Then at 66, on the opposite page, there is a reference to the position of marginal consumers, and a snip test, and then in the middle they say:

> "We recognise there may be some customers that require superfast speeds who

wouldn't switch to SBB in response to a SSNIP in SFBB."

Then it says:

"However, our evidence suggests that there appear to be few customers for whom SFBB is really necessary which suggests they may still be willing to switch down to SBB in response to an increase in the price of SFBB. Most consumers do not consider SFBB must-have. This suggests that CPs investing in SFBB have an incentive to price SFBB competitively relative to SBB in order to drive take-up. If the price of SFBB were too high, then we would expect most customers would continue to use SBB."

Then the conclusion, there is a discussion of future developments, but the conclusion is at 3.71:

"On balance, the evidence suggests that it is appropriate to define a single market for broadband services at all speeds. We acknowledge there are factors pointing to a separate market potentially emerging at the retail level for SFBB products at some point in the future; however there is insufficient evidence to conclude that this is likely to occur during the three-year forward-looking period of this market review, therefore we define a single retail product market including fibre, cable and copper-based products at all speeds."

Then there is a reference to its compatibility with the EU approach.

The Tribunal will, of course, be aware that in the decision with which we are concerned, section 2 looked at the position and decided that the market analysis was still valid for the purposes of the decision in this case.

The second topic is the relationship between SBB and SFBB, if I can call it that, standard and superfast. I don't propose to get into that in any great detail. Mr. Tickel describes it at some length at paragraphs 14 to 22 of his witness statement. That's at bundle II/3/10 to 12. I had the pleasure of attending a demonstration at Judd Street, Openreach's headquarters, which did, in fact, give quite an interesting explanation to a layman of how the two products differ, and what I came away with, and no doubt Mr. Tickel will give a more intelligent account, was that essentially the VULA product is a form of fibre bypass from the exchange to the cabinet adjacent to between 100 or 200 residential premises, but effectively it cuts out the copper link between the exchange and the cabinet in a way that is both much, much quicker, but also much more reliable, and it doesn't require a massive copper link; it requires just a single fibre from the exchange to the cabinet. So it effectively is a by pass which BT can use, but which also Sky and TalkTalk can use. But Mr. Tickel gives a more

technical account of the relationship between that product and the old MPF and SMPF products, and that's at the passage I have referred to.

Thirdly, fourthly and fifthly -- and I will take it quickly because I am sure the Tribunal is very familiar with it -- there are the market positions of Virgin, Sky and TalkTalk, and I will simply give the references as they appear in the BT evidence.

In relation to Virgin, the main discussion is in Mr. Murray's witness statement, paragraphs 37 to 44, 73 and 76 to 77, which is at bundle II/5/12 to 13, 18 and 20 to 21.

In relation to Sky, Mr. Murray discusses the position at paragraphs 21 to 36, 73 and 75, again, which is 2, 5, 7 to 11, 18 to 20.

Mr. Petter also discusses Sky at paragraphs 34 to 37, 75 to 86 and that's at 2, 10 to 11 and 25 to 27.

Then in relation to TalkTalk, Mr. Murray discusses that at 45 to 54, 73 and 78 to 79, bundle II/V pages 13 to 15, 18 and 21.

I think it may be just worth turning up the summary of the position as Mr. Murray states it, which is at paragraph 73 of his witness evidence, which is at bundle II/5/18. The gist of Mr. Murray's evidence is summarised there:

> "In providing standard broadband and SFBB services, BT has effectively faced two main competitors, Sky and Virgin Media, coming from very strong positions in different areas. Virgin Media has always been very strong in its provision of standard broadband and SFBB services using its own network and has access to a wide range of content. Sky has a currently unassailable position in pay TV and has now moved into the provision of standard broadband and SFBB as well."

So he picks out Virgin and Sky as the principal competitors, but he then gives a table setting out the position of the four different competitors and the position of TalkTalk is described at paragraphs 78 and 79.

The sixth topic I was going to deal with, which is a somewhat more esoteric one, but it also appears from the evidence of Mr. Murray, at paragraphs 25 and 46. Paragraph 25 is at pages 7 to 8, and he gives a fairly lengthy account of -- or a slightly more detailed account, in any event, of the expansion of LLU from 2005 onwards, and if one goes to the top of 8, one sees that by 2014, Sky had 94.4 per cent UK network coverage via LLU, and then it goes on:

> "Sky competes in the provision of standard broadband services by utilising Openreach's supply of LLU, also known at MPF..."

As explained in Mr Tickel's witness statement. In broad terms, MPF is where both the phone line and the data line, if I can put it that way, are under the same control:

> " ... whereas in contrast, BT Consumer bases its supply of standard broadband services on regulated supply of wholesale line rental (WLR) and shared metallic path facility (SMPF) services, again on regulated terms".

So BT was required by Ofcom to split them so that in principle somebody could do one or the other. So BT has to provide a sort of double service, whereas Sky and TalkTalk have an integrated service.

Then he goes on:

> "However, inserting the regulated prices for MPF and WLR since 2005, Ofcom made a policy decision to maintain a price differential between MPF and WLR that did not reflect underlying cost differentials in supplying the two services."

Then it goes on:

> "In the FAMR decision [which is at tab 20 of the big BT bundles] Ofcom decided to remove this differential, although only over the period of the current charge control such that by March 2017, the price differential between MPF and WLR would equal the cost differential. In making its decision, Ofcom noted that in December 2012 the price differential between the Openreach charge for MPF paid by Sky and the combined charge for WLR and SMP paid by BT Consumer was £19 while the cost differential was less than £4."

Then he refers to paragraph 6.6 of FAMR:

> "This provides an indication of the regulatory advantage that Sky has enjoyed and will continue to enjoy until the impact of the differential is removed by March 2017."

Then at paragraph 46 he makes the same point in relation to TalkTalk.

I think that section 6 of FAMR is now in the bundles. I don't think we need to turn it up, but it is at bundle III, part II, tab 8, pages 136 to 152. You will appreciate that this factual situation, which is created by Ofcom's regulatory choices, coincides with the regulation with which we are concerned, because it will run until March 2017 and, in principle, the VULA condition runs to March 2017. So the point I am making is that there is a substantial price differential in favour of Sky and TalkTalk on the standard broadband market over the same period. That's a choice of Ofcom's, not of BT.

Seventhly, BT's investment in VULA rollout, which obviously provides the factual context to all of this, and I suspect the Tribunal will have seen that the outline was that

an investment choice of 1.5 million was made I think in 2008 or 2009. That was then upgraded to 2.5 billion -- I don't know whether I said million, but billion in any event -- after that, and it is then upgraded to 3.5 billion out of public funds, which is where we are at the moment.

So I think initially BT was aiming to cover about two-thirds of the country. It then decided to increase to something like three-quarters, and with government funding it is now up to about 90 per cent.

The references are at Mr. Petter, paragraphs 14 to 16, bundle II/1/5; Mr. Tickel's first statement, paragraphs 43 and 52, bundle II/3/18 to 21; and Mr. Murray, paragraph 59, bundle II/5/15.

I think it is just worth looking at Mr. Tickel's evidence on this, which is the most detailed, and which has proved to some extent contentious. That's at tab 3 of bundle II.

So the point I have already made is summarised at paragraph 44 about the 2.5 billion extension. I may have got the proportions wrong, but that's the gist of it. I think he is saying it goes up to two-thirds with the 2.5 billion, and then it is now up to -- we are now on the final stage where the Government has become involved.

Then paragraphs 47 and 48, Mr. Tickel makes a point which I think is pretty central to the case:

> "In order to recoup the significant investment in fibre, Openreach has worked to make its GEA offering attractive to all CPs. Openreach has strong incentives to grow new incremental volumes of fibre customers. BT Consumer was an early adopter of fibre, and BT's strategy in adopting fibre and upgrading existing copper customers to fibre is detailed in John Petter's statement.
>
> "However, the long term economics of the BT Group Investment case are highly sensitive to volumes, which means that take-up is required across a range of CPs and not just downstream BT. Openreach has therefore engaged with CPs to try and overcome any technical and/or commercial problems associated with the provision of SFBB."

Then over the page, there is quite a striking chart of the position that TTG and Sky have achieved over the two years leading up to the imposition of this condition. But in combination, at least, they seem to have moved from about [Confidential] connections to almost 1 million connections. I am told that it is confidential information, so I apologise, but I suspect it is BT confidential. I think probably the outline, I will confirm whether that is a confidential fact, but the tendency of the graph, I think the Tribunal can see for itself.

The next point, which to some extent moves into the area of design, but which is obviously important as a background issue, is BT's investment in sports rights, and in particular sports rights over the past two or three years. I suspect that the outline of that is well understood by the Tribunal. I will simply give the references. Mr. Petter, paragraphs 56 to 62, which is bundle II/1/17 to 20; Mr. Tickel, paragraphs 192 to 193, bundle II/3/81, and Mr. Murray, paragraphs 63 to 67, bundle II/5/16 to 17.

Then the 9th, 10th and 11th points, in fact, are the regulatory position that exists independently of the matters in dispute in this hearing.

First of all, the BT undertakings and functional separation. I am sure this will be explored in greater detail in evidence. That's Mr. Petter's statement, paragraphs 22 to 28, especially at paragraphs 23 and 24. That's bundle II/1/6 to 8; Mr. Tickel's statement paragraphs 30 to 42, especially at 30 and 42, bundle II/3, paragraphs 15 to 18. The short point is that the BT witnesses say that this is a highly material impact on its incentives and it is something which Ofcom has completely ignored in its decision.

The tenth point, the FRAND regulation of BT's margin since 2010, that's addressed in Mr. Tickel's evidence at paragraphs 75 to 80, bundle II/3/30 to 32, and should the Tribunal be overwhelmed by curiosity, it is also at tab 15 of the BT documents, pages 142 to 145. Mr. Tickel quotes from the relevant 2010 document, but the actual document is in the soft copy bundles.

Then in relation to the position in the FAMR case, in relation to this issue and price control aspects of FRAND, the Tribunal will find that explained at some length in the FAMR document itself, which is at bundle III, part II/8. I will just give the references, it is page 172, 191 to 192, 385 to 386 and 407, which is paragraphs 10.1; 10.75 to 10.82; 12.149, and 12.253 to 12.254.

The outline position is that there was, as it were, a general regulatory remedy imposed and a specific VULA regulatory remedy imposed, and the FRAND obligation applied at both the general and the specific level, but in relation to VULA it was supplemented by what's called an equality of inputs obligation as well, and that is explained in the FAMR document.

Then, finally in this sort of high level circuit of the facts, the effects of competition law -- I am sure the Tribunal is fully aware, and it appears in our pleadings, and it is in the authorities at authorities V/60, that TalkTalk complained that BT's pricing of superfast broadband involved an abusive margins squeeze, and in parallel to this exercise, Ofcom investigated that matter, and in October 2014 -- so in the middle of the consultation, Ofcom found that it was an unfounded allegation, even on the numbers, so there wasn't even

an arithmetical margin squeeze in the wording that Mr. Bishop has used, and so they closed the file without having to look at the alleged competitive effects. We will come to the significance of that in a moment.

So that was by way of a sort of high level reference to some facts and some references in the bundles, which I hope has been useful to the Tribunal in getting its head round the evidence.

The second topic is general criticisms of Ofcom's pleaded case, and our core criticism under Ground 1 is that Ofcom's analysis of relevant risk, for the purposes of section 88(1)(a) of the Communications Act 2003 does not stand up to scrutiny. Just by way of outline, the final statement on which this decision is based devotes only 14 of its 302 pages to this issue, paragraphs 3.57 to 93, and rests heavily on assertion of the existence of a relevant risk, plus some projected collated market share figures, which I will make some comments on in due course.

Similarly, in this appeal, Ofcom's case rests heavily on assertion that its market analysis is sufficient to meet the statutory requirements, and one finds that, for example, at paragraphs 36, 38, 40 and 42 of Ofcom's skeleton argument, where it largely says: we did a great job, then full stop, move onto the next point, which is at pages 14 and 15 of its skeleton.

Ofcom maintains that it meets the requirements, as we would say, of section 88(1)(a) if it can identify a theoretical hypothesis of risk and, secondly, BT fails to provide evidence that Ofcom deems to be sufficient to eliminate that hypothetical risk. We say that is wrong -- it's the wrong approach, it's wrong in law, and it leads to the unsatisfactory factual case of which we complain.

In the final statement, Ofcom asserts that in the absence of regulation there would be a significant and real risk that BT has an incentive to impose a price squeeze -- that's from paragraph 3.64 -- but Ofcom doesn't actually find that BT would have such an incentive in the real world, and one finds that not only in the final statement, but also in the evidence of Mr. Matthew, which we will obviously explore in cross-examination, but I think it may be worth just looking at it at paragraph 9 of his statement, which is at bundle II/12/3. He says:

> "In this statement I explain why, absent regulation, there would be a relevant risk of adverse effects from a price distortion in respect of VULA."

Then he says:

> "Absent regulation, there is a real and significant risk that BT would have an incentive to set the VULA price in a way that favours BT's downstream retail

business, including through implementing a price squeeze."

So he is not saying that there is actually such a risk; he is saying that on the hypothesis that BT was unregulated, there would be such a risk, because absent regulation does not mean if we did not take this new measure, it means absent any regulation, and that's quite clear from both Ofcom's analysis in the final statement, but also in its defence and skeleton argument. So we say that it is a theoretical risk, and then when you look at what it is that is said is a risk, one finds that in the final statement itself at paragraphs 3.62 and 3.64, which is at volume III, part I. One sees in the middle of 3.62, in terms of ability, it says:

"Influencing the retail margin available to its competitors by adjusting its VULA charge relative to its retail price is one way BT could do this."

Which is influence the ability of other CPs to compete. Then it says:

"All else equal, the lower the differential, the harder it is for other CPs to profitably compete with BT's retail superfast broadband offers."

Then further down, in 3.64 in relation to incentives:

"BT is vertically integrated [it's line 4] and could set the VULA price with an eye to the impact that this will have on the ability of rivals to compete with it in retail markets, for example, raising the VULA price will raise BT rivals' costs in supplying superfast broadband. If BT does not raise its own retail price, then its retail business can win a larger share of downstream sales."

So it is simply the fact that if BT raises its price on the upstream market, and doesn't raise its price on the downstream market, that will tighten margins. But that, of course, is true of any price competition: if you reduce your price, or maintain your price when upstream costs increase, that will, to some extent, put pressure on your competitors, but that is, in normal circumstances, thought to be a good thing, and price competition in operation, and Ofcom doesn't really explain what, beyond that, it is concerned about.

Paragraphs 3.77 to 3.82 of the final statement then exclude consideration of whether existing regulatory constraints in the assessment of risk should be taken into account in the assessment of risk, which confirms the theoretical nature of the analysis, and that's paragraph 3.78, and then effectively place the onus on BT to disprove the existence of this theoretical risk.

We say the same approach is reflected in Ofcom's skeleton argument, for example, at paragraphs 83, 86 and 89, and in the evidence of Mr. Clarkson and Mr. Matthew.

Mr. Matthew, for example, at paragraphs 60 and 78, which is at bundle II/11/21 and 25, and of Mr. Matthew at paragraphs 57 and following, and we deal with it in some detail in our

reply at paragraphs 56 to 58, which is at 19, 20, 21.

I will come to all these points in more detail by reference to the law in a moment, but by way of further general criticism of Ofcom, we say that in the final statement, and the defence in its skeleton, Ofcom failed properly to engage with or even apparently to understand a number of other important points advanced by BT, and I will just pick out four.

First of all, and we have already touched on this, the relevance to BT's incentives of the functional separation between Openreach and BT's retail divisions, and the associated undertakings given by BT in 2005. At paragraph 137 of its defence, Ofcom claimed that this point had not been pleaded, but we then pointed out that it was pleaded at paragraphs 45(1)(a) and 5 of the amended notice of appeal and we set out the case in more detail in the reply, paragraphs 45 to 52, which is 15 to 21 and 23, and 17 to 19.

The second point we say they haven't properly addressed is the need to balance the risks of intervention with the risks of BT engaging in an abusive margin squeeze, a point that Mr. Bishop makes in section 6 of his first report, which is at bundle II/9/45 to 47. At paragraph 100 of its skeleton, Ofcom claimed that this point wasn't pleaded, but one finds it at paragraph 86 of the amended notice of appeal, bundle I/5/40, summarising Mr. Bishop's analysis.

Thirdly, the point that we take that the bias against regulation is, in fact, a policy of Ofcom's that it's had for many years, referring to their own impact assessment guidance. At paragraph 101, Ofcom claims that that is not pleaded, but it is, in fact, pleaded at paragraphs 81 and 230.5 of the amended notice of appeal, which is at 1 to 5, 39 and 91, and it is set out explicitly at paragraph 13 of the reply at page 6 of the reply.

Then finally, the Sky issue, I don't propose to go into it in any detail, it has been pleaded out, the relevance to any analysis of BT's incentives or any likely impact on competition arising from Sky's market strength in the pay TV sector, at paragraphs 92(b) of the defence, Ofcom claim not to understand BT's point, but we have set it out, in fact, reasonably fully at paragraphs 45.3 and 4 of the amended notice of appeal, which is at 15.22, and then, given the complaint, we spelt it out in more detail at paragraphs 81 to 86 of the reply, pages 31 and 32 of bundle I, tab 9.

So I now turn to the substance of BT's case, on the way in which section 88(1)(a) is to be interpreted and applied on the particular facts of this case, where Ofcom has decided to conduct a separate and specific analysis of whether an enhanced price control should be introduced beyond that provided for since 2010. That's the point that the Tribunal ruled on

in its initial ruling at paragraph 42 of that ruling.

I will look at the relevant legislation in a moment, but we say in substance there are three core elements to section 88(1)(a) and (3) of the Communications Act. For the Tribunal's note, that is at authorities bundle I, tab 16, pages 53 to 54, but it is also set out at paragraphs 24 to 26 of the amended notice of appeal, which is at pages 14 to 15 of that.

We say there are three elements: first of all, Ofcom must show a real risk, ie not a theoretical or a hypothetical risk; secondly, that risk must be shown to exist in the real world, so for example, the market analysis conducted for this purpose must take full account of the actual circumstances prevailing in the absence of the proposed control; thirdly, it must provide evidence of a risk of a real margin squeeze; ie the abusive conduct defined in the case law of the court of justice, not some watered-down version that is indistinguishable from competition on the merits. We say that Ofcom has failed in all three respects: both as a matter of law, and therefore as a matter of fact.

I will take these elements in turn and consider each by reference to the legislation and, more briefly, the relevant case law.

I emphasise that in each case it is not enough for Ofcom to assert that its market analysis met the relevant standard. These are substantive requirements that must be met by credible evidence, in particular, it is not possible to extrapolate from collated evidence of projected market shares that there is a real world risk of anti-competitive conduct that might lead to consumer harm, and in the papers there is an article, or a speech, given by the current chief executive of the Competition & Markets Authority, Mr. Chisholm, who is experienced both in competition law and telecoms law, where he goes into some detail about the perils of ex ante regulation in a developing market.

I've already looked at the facts, but I will draw attention to four elements, which we pick out at paragraph 54 of our skeleton argument as important context for the Tribunal to take into account in assessing whether the market analysis on which Ofcom relies is fit for purpose, and that's at our skeleton argument, page 17. It may be worth just turning that up as a convenient way to summarise it.

First of all is the investment of 2.5 billion in the next generation network, which we say is relevant to our incentive to engage in a margin squeeze that would drive business off that network, and we give a number of references, some of which I have already shown the Tribunal.

Secondly, we say that Sky and TalkTalk, who are the obviously principal complainants here, have quite different incentives in that they have made only very limited investments in

fibre and have both focused their respective investments in LLU, and I think that was taken as some form of criticism, but it was a commercial choice they have made, but they are obviously in a different situation in terms of their incentives from BT. BT has made a whacking investment in fibre, and a massive investment in sports rights. It obviously has different incentives from both Sky and TalkTalk, and here specifically in relation to the relationship between SFBB and standard broadband, and then we have made the point also about the pricing advantage that Sky and TalkTalk have on the standard broadband market. So that's something that needs to be taken into account in the overall assessment.

Then the third point, which to some extent goes in the other direction, but is also a curious basis for thinking that the current regulatory regime was not fit for purpose and needed to be supplemented, is the seven to eight-fold growth of the subscriber base of both Sky and TalkTalk over the exact period from April 2013 to April 2015, preceding the addition of this further element of regulation. We say that that's a very relevant matter for the Tribunal to consider as to whether this really looked like this was a market that was liable to be hit by an abusive margin squeeze.

Then finally is the historic investigation, but a very recent historic investigation, undertaken in the unusual circumstances of actually during the very consultation, Ofcom was also looking at this matter, so it's not like it was a very historic exercise, of the actual circumstances in this very market, conducted up to October 2014. We say that's another factor that the Tribunal should have in mind in analysing the submissions I am about to make.

So I turn first of all to the question of risk, which we say must be a real and not some hypothetical risk. First of all, there's the general question of how the Tribunal should approach an appeal of this kind, which is a venerable topic which has attracted a great deal of ink both from academics and from the Tribunal itself, and to some extent the Court of Appeal and even the Supreme Court and for many years we would say that when confronted by challenges of this kind, Ofcom has sought to argue that it enjoys a wide, general discretion to determine how to regulate the UK telecoms market, constrained only by the general objectives of the framework directive, and one finds that in the defence. In particular, Ofcom refers to judgments on different issues, or in other areas of law, where non specialist judges of the administrative court have shown substantial deference to the discretionary decisions of expert regulators and, in particular, we find Ofcom referring once again to the Cellcom decision, which is at tab 36 of authorities bundle II in its skeleton argument at paragraph 18 in as it did unsuccessfully in the Vodafone case back in 2008.

One finds that in authorities bundle II/41, paragraph 48.

We would say that in public law terms, Ofcom naturally and understandably seeks to push the analysis as far as possible towards a Wednesbury appraisal of the exercise of its regulatory discretion, and we say that while there are some decisions under the CRF where the NRAs are certainly given a significant discretion, for example, in the definition of the relevant markets, the scope of their jurisdiction to impose regulatory conditions is carefully defined by the statutory regime itself, and does not confer such a broad discretion. In such cases, we say, Ofcom's approach is not correct: either in general or in the particular circumstances of this case. We say this can be seen from the structure of the CRF itself, and from case law of the highest authority on that legislation.

Turning to the specific issue of prospective risk, BT refers to closely analogous case law in the field of competition law and, in particular, merger control, where prospective analysis does have to be undertaken. We say the substance of that case law is that precisely because of the risk of error in prospective analysis, the imposition of restrictive regulatory conditions, including in particular here SMP price controls, must be based on a careful and realistic forward-looking analysis and must be based on evidence, not on vague or theoretical considerations and we say if you apply any sort of rigorous standard, this decision falls to the ground.

MR. ALLAN: Do you have particular ECJ authority that you rely on in relation to that proposition?

MR.THOMPSON: Yes, I was going to take the Tribunal to the Tetra Laval case which I think is the leading analysis on prospective analysis in the merger context.

MR. ALLAN: I was anticipating that. Tetra Leval, of course, is a conglomerate merger case so perhaps you will --

MR.THOMPSON: Indeed, my Lord. I do indeed have a submission about that, which in some sense comes on to the final point about what sort of bear in the woods are we looking for here, and we say it is a real bear, not a little toy bear; it has to be a real margin squeeze.

So first of all on the structure of the CRF, we say that to get your bearings as to the right approach to adopt -- I should say that I don't think any of this will come as a great surprise to Mr. Allan, because I think he was one of the members of the Tribunal in the Telefonica case, but I will set the point out in any event -- we say it is worth first of all looking at the statutory regime and we say that Ofcom tends to favour starting in the middle of that exercise by emphasising the general consideration that it must take into account in the exercise of the various powers and duties, and one finds that in a typical form at

paragraphs 23 to 26 of the defence, where it says "Legal framework" then you are straight into the article 8 objectives under the framework directive.

But we say that the logical and correct place to start is with the source and the extent of those powers and duties themselves, deriving ultimately from the harmonised regulation under the CRF of the freedom to provide telecoms services within the EU, and we set that out in some detail at paragraphs 6 to 19 of our reply.

In partial response, Ofcom relies on the guidance of the CAT in the Court of Appeal in the pay TV litigation at paragraph 16 of its skeleton. It may be worth just looking at that. This is a general discussion of the nature of appeal on the merits, and the Court of Appeal approved a dictum of the Tribunal. I simply note that, as Ofcom correctly sets out at the beginning, it says:

> "This was an appeal from a decision under section 316 [of the Act]."

Then at point (d), in assessing the sort of relevant factors, the Tribunal says:

> "When considering how much relevant weight to place upon those matters [so whether to give a discretion or not], the specific language of section 316 to which we have referred... are clearly important factors..."

And also the nature of the investigation.

So we say precisely so, what you have to look at here is what was the exercise that Ofcom was required to do under the legislation. So we have no objection to this guidance, but we say that in the -- it wouldn't matter if I did have any objection to it, but applying that guidance requires one to look at the actual legislative scheme here, and so that's what I propose to do now, which I hope will be of assistance.

We say that in relation to the imposition of regulatory conditions, the starting point is the rights granted by the treaty on the functioning of the European Union itself, which go right back to the old EC Treaty, and the specific harmonising measures of articles 3 and 6 of the authorisation directive which govern the imposition of conditions and are reflected in section 45 of the Communications Act.

So if one takes authorities bundle I, I will take this as swiftly as I may, but I think it would be helpful to the Tribunal to see how this regulatory system evolves.

The Tribunal sometimes takes a break when there is a transcriber, shall we get through this?

THE CHAIRMAN: Yes, I was going to suggest a break at some point. Would this be a convenient moment?

MR.THOMPSON: We could now. It depends how excited you are at the prospect of going through the CRF.

THE CHAIRMAN: I think I can wait a few minutes. We will have a break of five minutes.

MR.THOMPSON: Yes.

(11.27 am)

(A short break)

(11.34 am)

MR.THOMPSON: Sir, just for the Tribunal's record, the Chisholm speech to which I referred is the final authority in the authorities bundle, tab 63 in authorities bundle 5.

If one takes up authorities bundle I, you will find that the legislation is set out in a convenient way, first of all at tab 1, one finds article 56 itself. There was a wrong 56, but I hope this one says "Services" at the top, and so it says:

> "Within the framework of the provisions set out below, restrictions on freedom to provide services within the Union shall be prohibited [then it goes on] ... in respect of nationals of member states who are established in a member state other than that of the person for whom the services are intended."

So, in one sense, BT is not a deserving case, but the reality is that everyone gets the benefit of the harmonised rules, whether or not you are actually within the scope of the regime, and one finds the system set out in relation to this particular issue, regulatory conditions, at tab 4, the authorisation directive.

I anticipate the Tribunal will be familiar, but there are essentially four directives: there is a framework directive, an access directive, an authorisation directive and an universal services directive and, effectively, this one governs regulatory conditions. Access is reasonably well known and we will come to in a moment, and universal service is largely about universal service, but it also covers a number of retail issues.

One sees at recital 3, the objective of the directive is set out:

> "... to create a legal framework to ensure the freedom to provide electronic communications networks and services, subject only to the conditions laid down in this Directive, and to any restrictions in conformity with article 46(1) of the Treaty, in particular measures regarding public policy, public security and public health."

So that's the bulls-eye objective of the legislation.

Then at recital 7 it says:

> "The least onerous authorisation system possible should be used to allow the provision of electronic communications networks and services in order to stimulate the development of new electronic communication services ..."

So that's the way in which it is going to be done. It is a harmonised regime to minimise regulation.

Then over the page at 15 and 17, there's reference to specific obligations. So there are various things about general obligations, and then 15 and 17, there's reference to the specific obligations, limited to what is strictly necessary, and then 17:

> "Specific obligations should be imposed separately from the general rights and obligations under the general authorisation."

So it is a deregulation system intended to prevent the national rules restricting the freedom to provide telecom services, and one finds that in article 1, paragraph 1 of the actual provision, setting out the aim, which is essentially the same as the objective in the third recital.

Then, getting into the meat of it, after the definitions you find article 3.1 and 2:

> "An obligation is placed on the member states to ensure the freedom to provide electronic communications networks and services, subject to the conditions set out in this directive."

So that makes it clear that what's happening is the legislator is harmonising the extent to which that freedom can be restricted, and then there is reference to the treaty article. Again, it says 46, but I think the Tribunal will have probably have noticed that 56 is ex-46, so it is the same provision we have looked at.

Then the key provision is 3.2, which says:

> "The provision of electronic communications networks or the provision of electronic communications services may [and then there is a parenthesis] (without prejudice to the specific obligations referred to in article 6.2) [and then another exception we don't need to worry about. Then it goes on] ... only be subject to a general authorisation."

So that is the general provision: that you can't have anything apart from a general authorisation except for these two specific exceptions.

Then you go on into article 5, which is the other one you don't need to worry about, and then you go on into 6, and 6.1 describes the general requirements by reference to the conditions set out in an annex and restricts them to non-discriminatory, proportionate and transparent versions of that annex, the annex is at the back of the directive. Then 6.2 deals with specific obligations, and it is fairly densely written, but I can unpack it for the Tribunal. It says:

> "Specific obligations which may be imposed on providers of electronic

communications networks and services."

Then it in fact has four categories. The first is under articles 5.1, 5.2 and 6. These are access obligations, which don't depend on significant market power, so they are general access obligations.

Then there is reference to 8 of directive 2002/19, which is actually the provision we are concerned with, which is significant market power conditions.

Then it goes on, article 17 of directive 2002/22, which is actually the universal services directive, and those are retail SMP obligations.

Then, fourthly, those designated to provide universal service under the said directive. So that's things like telephone directories and fixed lines, at least, sort of minimum obligations for relatively poor or handicapped people, things of that kind. So it is those four categories of specific obligation that can be imposed, and they are the only derogations from article 3.2, so they are the only restrictions apart from the general conditions that the member states can impose.

There are one or two minor exceptions with the universal services obligation directive, but for the purposes of this, that is the regulatory structure, and one sees that in article 10, the enforcement of conditions, that:

> "The NRAs under 10.1 are required to monitor and supervise compliance with the conditions of the general authorisation or of [and then you go on] ...the specific obligations referred to in article 6.2."

So it's the same four categories, and that's how the system works. So you have general obligations and four specific categories of specific obligations, including article 8 and the SMP conditions.

If one then goes slightly out of our course into the framework directive, which is the sort of overarching directive, you find that at tab 2, and I take it in this order because there is a sort of provision in relation to SMP conditions which bears on this, and one finds that referred to in recital 27 on page 8 of the version we have. It says:

> "It is essential that ex ante regulatory obligations should only be imposed where there is not effective competition, ie in markets where there are one or more undertakings with significant market power and where national and community competition law remedies are not sufficient to address the problem."

Then it goes on into detail about how that is to work in practice.

Then one finds the specific provisions in article 1 itself, and in particular, 1.1, which states that:

"The directive establishes a harmonised framework for the regulation of telecom services."

So it emphasises the harmonising nature of this. That's actually reflected, I think, in the power for this directive, and then if one goes into the more detailed provisions, article 7 is the utmost account provision, which is relevant to the second ground of appeal, but it is also relevant more generally here, that it says:

"National regulatory authorities shall take the utmost account of the objectives set out in article 8, including, as they relate to the functioning of the internal market."

Then there is reference to working with the Commission and BEREC in 7.2 and so this is the legislation which is relevant to Ground 2.

Then if you go on to 8. 8.1 says:

"Member states shall ensure that in carrying out the regulatory tasks specified in this directive, and the specific directives, the national regulatory authorities take all reasonable measures which are aimed at achieving the objectives set out in paragraphs 2, 3 and 4. Such measures shall be proportionate to those objectives."

So the point we are making here is that the regulatory tasks specified here are the setting of conditions, and that is the process we have been looking at under the authorisation directive. So that's what they are doing; they are not simply wandering around doing what they think looks good under article 8. What they are doing is setting specific objectives under the authorisation directive and this is, as it were, ancillary, and tells them how to do it, or the considerations to take into account.

Then I think we can then skip on to article 16, which deals with market analysis procedure. It tells them that they have to carry out an analysis, taking utmost account of the Commission guidelines.

At 2, it poses the obligation to effectively see whether a market is effectively competitive, and then 3 and 4 set out a positive and a negative obligation. So if they find that it is competitive, they are not allowed to impose any specific regulatory obligations under article 8 of the access directive. Where they find that it is not competitive, they have to identify the undertakings who have significant market power and then impose appropriate specific regulatory obligations. So that's the way it works; they are not allowed to, if it is competitive, and they have to apply the article 8 procedure, or the article 17 procedure of the universal service directive if it is a retail market, and that's the regime that Ofcom is

operating under.

Turning to the access directive, which I can pick up now, that's at the next tab, tab 3.

I think we can go to recitals 13 and 14. There is a description of how the market analysis should be carried out in this context, and then at 14, there's reference to the predecessor directive, which laid down a range of obligations to be imposed on undertakings with significant market power, and it identifies four: transparency, non discrimination, accounting separation, access and price control. In fact, that is five, and:

> "This range of possible obligations should be maintained but in addition they should be established as a set of maximum obligations that can be applied to undertakings in order to avoid over-regulation."

So again, it emphasises the harmonising nature of this and that the member states don't have a general freedom. Then recital 20 on the other side gives them guidance in relation to price control, and in the middle there is reference to a price squeeze, and this is a passage that I think Ofcom has referred to in a number of places, a price squeeze:

> "Whereby the difference between their retail prices and the interconnection prices charged to competitors who provide similar retail services is not adequate to ensure sustainable competition."

So that's one of the circumstances in which price control can be imposed.

If you then turn in to the legislation, again there is a description of the scope under article 1.1. There are definitions, and then there is a section which effectively deals with access problems when there isn't significant market power, and then at article 8, 8.1 requires the NRAs to have the power to impose what are, in fact, SMP obligations, and they are specified under articles 9 to 13(a). So that is what the focus of the SMP powers is.

8.2 effectively reflects the provision we looked at in article 16 of the framework directive, because it requires at least one of these obligations to be imposed where they find significant market power.

Then 8.4 is a sort of ancillary provision requiring the condition to be based on the problem that they have identified and proportionate and justified, and there is also a consultation obligation.

Then when you look into the detail of these obligations there are five: one is transparency, article 9; the second is non discrimination, article 10; the third is accounting separation, article 11; and then 12, the access obligation, which goes beyond the general access obligation and gives wide powers to the national regulatory authorities to impose a number of detailed conditions in relation to granting access to networks.

Then, finally, we have article 13 of the original four conditions, which is in relation to price control, and then the fifth one, which I will come to in a moment, relates to functional separation.

13.1 again refers to the topic of price squeeze, and you find it in the middle:

> "The National Regulatory Authority may impose price controls ..."

And if one jumps on:

> "... in situations where a market analysis indicates that a lack of effective competition means that the operator concerned may sustain prices at an excessively high level [so that's excessive pricing] or may apply a price squeeze to the detriment of end users."

So it's not only an arithmetical price squeeze as I would say it, but it has to also be to the detriment of end users, so it has to have effects and (inaudible), that's what we call a real rather than an arithmetical price squeeze.

13(a) provides for -- this was an addition that was made in 2009 and implemented, I think in the UK, in May 2011, is an exceptional power for Ofcom or the NRAs to impose what's called functional separation, which is pretty much exactly what happened here in 2005, whereby a vertically integrated company is required to set up a separate business entity within its corporate group to effectively address any problems about discrimination on a sort of structural basis.

But you will see from 13a(i) that it is a fallback provision that arises only:

> "Where the [NRA] concludes that the appropriate obligations imposed under…9 to 13, [so the four we have looked at], have failed to achieve effective competition and there are important and persisting competition problems and/or market failures."

So it's a fallback provision and there is also a procedural requirement to notify and get the approval of the Commission for that. So that is an exceptional fifth limb which has been added.

Then, for good measure, there is a sort of monitoring provision under 13(b) whereby if an undertaking does either create a second division or sells off part of its business, it has to notify the NRAs of the fact for the obvious reason that otherwise the new entity might not be caught by the regulation, so the NRA then has to analyse the market and see whether it needs to rejig the regulatory structure, so that's 13(b).

Now, all of this is implemented into domestic law, but before we look at that I think it is worth just looking briefly at the amending legislation, which is at tab 5, and in particular,

the recitals which relate to the provisions we have just been looking at, and in particular, recital 61, which is at page 15 of the clip where the legislator describes the purpose of functional separation. It says:

> "The purpose of functional separation whereby the vertically integrated operator is required to establish operationally separate business entities is to ensure the provision of fully equivalent access products to all downstream operators, including the operator's own vertically integrated downstream divisions. Functional separation has the capacity to improve competition in several relevant markets by significantly reducing the incentive for discrimination and by making it easier to verify and enforce compliance with non discrimination obligations."

Then it goes on to impose certain qualifications, because whether or not it may have effect on investment incentives. So it is regarded as an exceptional remedy and that is reflected in the legislation itself.

Then for good measure, 64 refers to the basis for the amendment that became article 13(b), but I think that is of less direct relevance.

Now, going, finally, to our own act, that's at tab 16. I wouldn't propose to go through that in any detail. I think in the Supreme Court, Lord Sumption indicated that we should focus on the EU regulation, because this is intended to implement it, and who am I to dispute that proposition? I will simply give you the references: the types of condition that can be imposed are at 45.2 at page 19, and it refers to four categories, and it is 45.2(b)(iv), the significant market power condition.

Then there are various procedural obligations which emerge in the following pages, which are intended, I think, to implement the EU regime.

The market definition process is dealt with at sections 79 and 80, which is at pages 36 to 39 of this clip, and the provisions with which we are primarily concerned, sections 87 and 88, are at pages 50 to 52 of this clip and, just in outline, 87.1 says that:

> "Where Ofcom have made a determination that a person to whom this section applies, defined as the dominant provider, has significant market power in an identified services market, it gives a general power under (a) and (b) to set and apply SMP conditions."

And in particular, 87.9 gives a price condition power, but that is subject to section 88, which is the very issue with which we are concerned, and you find that on pages 53 and 54 of the clip.

So, pulling that all together, we say the upshot of this legislation is that there is a significant onus on the NRAs, and in this case, Ofcom, to justify the imposition of specific regulation going beyond the general regulatory conditions set out in the annex to the authorisation directive, and the reason for that is any such regulatory condition constitutes a serious and substantial restriction on the fundamental freedom to provide services across the EU.

So if we now turn to the case law, I will take this briefly. I think there is one EU case that is worth looking at which is, in fact, my entrance into this interesting world, which is the case of The Number, which one finds at tab 30 of the second bundle of authorities. It is a case where in the Tribunal -- perhaps it would be cheap of me to say I didn't appear in the Tribunal -- the Tribunal was persuaded by Ms. Rose that there was a general power of Ofcom to impose obligations on BT to provide data in relation to directories and directory information, and the effect of that was that that data was to be provided at marginal cost, and the question was whether any such power actually existed in the legislation.

For that purpose, it was necessary to see how broad the powers of the NRAs were under, in this case, the Universal Service Directive, but, in my submission, exactly the same principles arise in this case, and the relevant part is at paragraphs 29 to 31. Just to complete the history, in the Court of Appeal we had a sort of score draw, and the Court of Appeal I think was persuaded that BT was correct, but didn't quite tip over the line, and so they referred the matter to Luxembourg and, in fact, in that case, the position was clarified, as I would say, and one finds at paragraphs 28 to 31, the relevant statement and, in particular, at 29, there's reference to article 3.2 of the authorisation directive, and summarising the point that I put to the Tribunal going through the legislation, and then at 30, at the beginning, having referred to 3.2 and 6.2, the Court of Justice says this:

> "Accordingly, member states are entitled to impose specific obligations or one or more individual undertakings only insofar as such obligations fall within the cases contemplated in article 6.2 of the authorisation directive."

Then there is reference to the Universal Service Directive, but then at 31:

> "As an exception to the prohibition on imposing specific obligations on operators individually, the obligations which may be imposed on the Universal Service Directive on undertakings designated in accordance with article 8.1 thereof to provide universal service are to be interpreted strictly."

In my submission, if one simply took out the words "specific to Universal Service Directive" and replaced them with the SMP conditions with which we are concerned, exactly the same reasoning would apply. So, in my submission, that's clear authority that

this is an area where a strict approach is appropriate.

We say that that's not surprising, either as a matter of principle or as a matter of authority, and for what it is worth, which is, of course, a great deal in this case, the Tribunal has taken exactly the same view in the Telefonica case, where I think Mr. Allan was one of the Tribunal members, which is at the fourth authorities bundle, tab 49, where it described the section 88(1)(a) requirements as "stringent".

For the Tribunal's reference, it's at paragraph 25, page 10.

MR. ALLAN: Sorry, which tab do you say it is?

MR.THOMPSON: It's the first tab of authorities bundle IV.

MR. ALLAN: Thank you.

MR. THOMPSON: In fact, in one sense this goes beyond because this is looking at the actual provisions of 88.1, but in my submission, it is entirely consistent with the general position I have just been looking at. Page 10, paragraph 25, in reference to the domestic legislation, and then it goes on:

> "The imposition of price controls is generally recognised as being the most intrusive form of regulation available to an NRA, and this is reflected in section 88 which lays down stringent conditions which have to be satisfied before such controls may be imposed."

Then it quotes the legislation. In my submission, that's entirely consistent with the approach of the Court of Justice to SMP regulation generally, and indeed makes the point that a particularly beady-eyed approach should be taken in relation to price control because of its intrusive nature.

Then in the previous authorities bundle, the Vodafone case -- I don't think it is necessary to take it out now, I will come back to it in a moment -- there is the wording which we rely on in the amended notice of appeal under Ground 1(A), where there is a test of profound and rigorous scrutiny which is applied generally to assessment of market analysis and cost-benefit analysis in particular.

We have addressed this in our skeleton, for example, at paragraph 14, and we say there is no tension here between the CRF and the approach that's been adopted by Ofcom itself in its statements of regulatory policy, and we refer in particular to the guidelines on impact assessment, which is at tab 17 of authorities bundle I. It might be worth just looking at that briefly. It has been quoted in the pleadings, but it is, as we would say, quite a striking statement.

It puts up in light a statement from the better regulation task force about the option of not

intervening, and then the statement by Ofcom, the second sentence -- well, the first sentence says:

> "The decisions which Ofcom makes can impose significant costs on our stakeholders and it is important for us to think very carefully before adding to the burden of regulation. One of our key regulatory principles is that we have bias against intervention..."

And then:

> "This means that a high hurdle must be overcome before we regulate. If intervention is justified, we aim to choose the least intrusive means of achieving our objectives, recognising the potential for regulation to reduce competition."

So it is, as it were, a two-stage process: do we regulate at all? If we do, it must be proportionate.

Our point here, and it is the point that was found by the Tribunal, is that we are in a slightly curious first stage process here, because there is regulation in place and so the decision here is tantamount to whether they regulate at all. We are concerned with the prior question. That is the question that the Tribunal is concerned with in this case, not with the proportionality question.

Then at 3.3, this is spelt out and in particular in the last sentence, the last two sentences:

> "We will start by considering the option of not changing the regulatory framework, either by not introducing regulation or by retaining existing regulation. This option no new intervention will generally be the benchmark against which other options are judged, ie what costs and benefits would be incurred additional to those which would be incurred if there were no new intervention."

So in my submission that is completely consistent with the analysis of what's at issue here. We are concerned with the new intervention, not with no intervention at all, because of these particular facts.

We say there is nothing surprising about this, of course, since as a matter of principle, and again, it is probably the Chisholm article, or indeed Mr. Bishop has made various statements which may or may not be challenged in his evidence, the need to satisfy a high jurisdictional threshold before imposing intrusive price controls is a matter of well recognised economic and regulatory common sense and we make that point at paragraphs 13 and 15 of our skeleton.

I turn now to the more specific issue that Mr. Allan raised with me, the issue of prospective

analysis in merger control and of relevant risk more generally, and we note that the issue of prospective risk of anti-competitive conduct and anti-competitive effects, which is the issue here, is strikingly similar to the issue that faces a competition regulator where it is addressing a complex issue of prospective market analysis, and that's the point we make at paragraphs 24 to 29, pages 8 and 9 of our skeleton.

We were effectively put to proof by Ofcom in its skeleton, and so it appears to us that of particular interest to the present consideration of the correct level of risk required to justify a highly intrusive price regulation is the approach that's been adopted by the Court of Justice in the context of merger control and, in particular, the leading case of Tetra Laval, because, of course, unlike anti-trust enforcement which is to a large extent, looking back, merger control is, of course, entirely prospective in its character.

We note that this case was referred to by the Tribunal in the 2008 Vodafone judgment, and we say that it provides helpful guidance on how the issue of prospective risk should be assessed.

So if we could look first at the Vodafone case, which is at tab 41 of the third authorities bundle. This is another vexed topic in telecoms law, which is number portability. So if you change your supplier, whether your number can be shifted across. We don't need to get into the detail of it; all we need to understand is that --

MR. ALLAN: Can I stop you just a moment. I seem to be lacking volume III. I have the pleasure of two volume Is.

MR. THOMPSON: I am sure it can be handed up.

MR. ALLAN: Which tab did you say?

MR.THOMPSON: Tab 41, and I was just saying that this is a case about number portability, but we don't need to get into it, all we need to know is that there was a market analysis and a cost-benefit analysis of whether or not regulating would or wouldn't be a good thing, and one finds that, first of all, at paragraph 31, you see there Vodafone identified the central issue in the appeal as being:

> "Whether Ofcom equipped themselves with a sufficiently rigorous analysis of the costs and benefits of the decision to enable them to reach a lawful decision in accordance with their statutory duties under the 2003 Act."

Then at 36, there's a summary of the previous case law, and the emergence of the profound and rigorous rubric, which one finds there at the bottom of page 17:

> "Vodafone accepted Ofcom enjoyed a measure of discretion."

But then they went on to say that the analysis of costs and benefits was manifestly

inadequate. One finds that at 37.

Then there is some preliminary analysis, but the meat of it, if I can put it that way, is at paragraphs 46 to 49, and in particular at the top of page 21, the Tribunal finds:

> "It is still incumbent on Ofcom in light of their obligations under section 3 of the Act... "

We haven't looked at that, but I anticipate that that won't be controversial, and it is not inconsistent with anything I have said:

> "... to conduct their assessment with appropriate care, attention and accuracy so that their results are soundly based and can withstand the profound and rigorous scrutiny that the Tribunal will apply on appeal on the merits under section 192 of the Act."

Then 47, Mr. Saini for Ofcom said that robustness was effectively a meaningless legal standard.

Then at 48, the Tribunal goes on:

> "The Tribunal was referred to several decided cases concerning the legal standard to be applied in carrying out prospective analysis."

Then there's actually reference to an Irish decision, which we have been unable to locate, but helpfully it referred to the Tetra Laval case which we certainly have, and there the dictum is:

> "Because the likelihood of error is greater in a prospective analysis, the prospective analysis must be proportionately more rigorous to account for this possibly."

Then Mr. Saini wheeled out Celcom and the Tribunal said:

> "... the observations of Lightman J were made in the materially different context of judicial review proceedings."

Then at the end they conclude that the profound and rigorous standard does apply and they don't, at that point, need to decide whether a prospective analysis requires a higher standard of rigour, so they leave that open because they say profound and rigorous is the standard.

So that's where it was left by the Tribunal in relation to a cost-benefit analysis, and so far as I'm aware, there is no criticism of that general approach.

If one looks at the Tetra Laval case, one finds that at volume I of the authorities again, so Mr. Allan should have at least one copy of that.

MR. ALLAN: I can look at it both ways.

MR.THOMPSON: It has been added, I hope, as a tab 23A to bundle I. I think what is necessary

is exactly what Mr. Allan put to me; is that this was the case of a conglomerate-type merger, and one sees that in the italicised headnote. Then it goes on:

> "The nature of prospective analysis required when examining such mergers. Correct judicial review criteria applied by CFI."

Then more detailed findings. Then it is summarised, the headnote, page 4 through to page 12 are a helpful summary of the findings, but I think it is worth going into the meat of the judgment, which is at pages 638 and following. It is actually a judgment where, quite helpfully, the judgment of first instance is quoted at some length, and that's at paragraphs 20 through to 24, but for the purposes of opening, at least, I won't go back to that. The gist of it is that a submission very similar to the one that Ofcom is making before the Tribunal was made was that this is all a discretionary matter and that the Commission should keep out. The CFI didn't think much of it, so the question was whether or not the first instance review had been wrong in law, and the Court of Justice, to jump ahead, found that it hadn't. There's some scene setting in paragraphs 37 through to 41, but I think the core findings are at 42 and 43:

> "A prospective analysis of the kind necessary in merger control must be carried out with great care, since it does not entail the examination of past events, for which often many items of evidence are available, but which make it possible to understand the causes, or of current events, but rather a prediction of events which are more or less likely to occur in future if a decision prohibiting the planned concentration or laying down the conditions for it is not adopted. Thus the prospective analysis consists of an examination of how a concentration might alter the factors determining the state of competition on a given market in order to establish whether it would give rise to a serious impediment to effective competition. Such an analysis makes it necessary to envisage various chains of cause and effect with a view to ascertaining which of them are the most likely."

So I think that's the germ of the point that was made to Vodafone; that whereas in a backward-looking case you have quite a lot to go on, you will have documents, you will have actual conduct, in a prospective analysis everything is, essentially, speculative. So it is important, if you are going to impose a restrictive regulatory obligation, in that case to block a merger, that you have some evidence to back it up. We say that that is very illuminating in terms of whether or not our criticisms are well founded, based on Vodafone, as to whether or not this, as we would say, wafer-thin analysis, is good enough to justify enhanced price controls.

MR. ALLAN: I don't want to interrupt prematurely. Are you moving off this point now?

MR.THOMPSON: I wasn't, actually. There are a couple of nuances in the judgment, and I think there's the point -- I don't know if you were going to make the point about conglomerate mergers being --

MR. ALLAN: Carry on, then I will ask my question.

MR. THOMPSON: I will take the point you have already asked me which is that conglomerate mergers are recognised as being ambivalent because you are getting different bits of the market being botched together and then there is obviously a question as to whether that will actually distort competition.

What we would say is that in a margin squeeze, intrinsically you are getting a consumer benefit: prices are being held down, and so, on the face of it, it's a good thing. Normally, if, for example, petrol prices go up but the supermarkets keep their prices down, normally everyone would think that is great. Likewise, if petrol prices stay the same and supermarkets reduce their prices, everyone thinks that's great.

So the question that Ofcom has to decide is whether or not BT putting its prices down, or BT not raising its prices, despite its input prices having gone up, whether that is a good or a bad thing. In my submission, that is at least as ambiguous a question as the question of a conglomerate merger. You have an intrinsic consumer benefit and they have to see whether or not there is actually a consumers' detriment. We say that in such a case this is very much in point: you can't just wave at the possibility that BT might reduce its prices because, on the face of it, that is a good thing. What you have to think about is whether or not they reduce their prices so much that something bad happens, and we say this analysis is absolutely hopeless for that difficult question.

The nuances I was going to point to, and I don't want to take up too much time in an opening, is that further in the judgment you find consideration both of the question of general competition law and of particular commitments that the parties had entered into, and just to sort of get to the chase, at paragraph 74 the judgment says that the Commission should have taken into account effects on incentives generally and, in particular, as one sees at the end of that paragraph, the possibility that proposed conduct was unlawful.

So they say that in general, in assessing incentive effects, the regulator needs to take into account whether or not certain types of conduct would be unlawful. We say exactly so: you should take into account existing regulation, and, in particular, they found that in that particular case, because it was an international merger, it would be too much to require the Commission to look at every individual competition rule throughout the countries that

were affected, that that would be too burdensome, and one finds that at 76.

So in that case they disagreed with the court of first instance and said: you don't need to look at every national competition rule and see whether or not particular conduct would be unlawful.

But they also went on, and one finds that at 85, that they said that the court of first instance had been quite right to take into account commitments that the undertakings had entered into, and we say both those points in substance help us; that you need to take into account the incentive effects of a possible illegal conduct, we say the fact that you might get fined £100 million is certainly something that BT would bear in mind in acting in certain ways, and one sees enormous sums have been imposed in Germany on an undertaking for imposing unlawful margin squeeze, we also say that the undertakings are a form of commitment and that they should certainly have been taken into account.

That's what we say you get out of the Tetra Laval case. I've taken it quite quickly, but that's the gist of what we are saying.

MR. ALLAN: If you are finished, I was just going to ask, just to invite your comment on the fact that in a merger control assessment, the Commission has to make a decision as to whether there is a substantial impediment to effective competition. So it has to make a definitive decision on the factual assessment, whereas here Ofcom's decision is as to the existence of a risk of a price squeeze, and whether that -- how that influences the way we should look at that paragraph in Tetra Laval that you took us to.

MR.THOMPSON: I see that distinction. I think the point I was making is that in contemplating whether or not to impose a restrictive condition, this was the analysis, and imposing price control is certainly a restrictive condition, but I will certainly think about that distinction, and if I have any brilliant insights on it, I will deal with it in due course, probably in closing, if I may.

MR. ALLAN: Thank you.

MR.THOMPSON: Or even if I don't have any brilliant insights, I will do my best.

By way of submission, we say the overall legal position that results from these authorities is that in an assessment of prospective risk as the basis for the imposition of an intrusive regulatory constraint, with obvious and serious negative implications for free market competition, it is particularly important to define the nature and extent of the relevant risk and to support a finding that such a risk is likely to eventuate by specific and realistic evidence that takes proper account of all the considerations bearing on the incentives of the dominant firm.

That is a bit of a mouthful, but maybe it will appear in the transcript. We say in particular, where the assessment of prospective risk is complex or finely balanced, the guidance of the Court of Justice makes it clear that it becomes particularly important that the standard of evidence required to support regulatory intervention is a demanding one, and we say that is the position here.

I will now go on to my second and third points, the need for a real world market analysis and the need for a real margin squeeze. I am conscious of the time, so I will try not to delay things too much.

We say that judged by the realistic standard that I have just described, a fundamental defect of the final statement and of the evidence of Mr. Matthew is that it is fundamentally divorced from reality, and we make that point at paragraphs 67 and 68, and I have referred the Tribunal to paragraphs 3.59 and 3.78 of the final statement, and also to paragraph 9 of Mr. Matthew's statement.

We say that because the hypothetical economic entity, or the undertaking, that is said by Ofcom to give rise to an alleged relevant risk, is a theoretical abstraction that bears limited, if any, proper realistic resemblance to the actual undertaking operating in the prevailing circumstances of the relevant downstream market, ie BT itself.

Ofcom is, of course, aware that in reality BT is one of the most heavily regulated companies in the United Kingdom; regulated not only under the CRF itself, but also pursuant to undertakings that were entered into in 2005, a central element of which was the functional separation of Openreach to create a separate service division with responsibility for delivery of equivalent inputs and services to all retail competitors. The entire point of this exercise was to modify BT's intensives as a vertically integrated company and thereby to promote downstream competition.

Although Ofcom relies on the undisputed fact that BT is vertically integrated to argue that its incentives are different from those of two legally separate companies, it has completely failed to take account of the different incentives that arise for BT from the fact of its functional separation as against a vertically integrated undertaking that is not subject to any such obligations. In particular, Ofcom has taken no account of the specific incentives of BT's retail divisions and their employees to maintain their profitability; for example, we set out references at paragraphs 46 and 47 of our skeleton, and Mr. Petter, the chief executive of BT Consumer, will explain this point to the Tribunal in his evidence. Indeed, he has explained it in his written evidence.

We say that Ofcom has also deliberately failed to take account of the fact that BT is also the

regular target of complaints and investigations pursuant to the Competition Act. Ofcom is, of course, aware of this fact because it has, itself, conducted a number of such investigations into BT, including a very recent investigation triggered by TalkTalk, which we have referred to, but there are other decisions which are referred to at tabs 58 to 60 of the authorities bundle V.

Ofcom, I think one can assume, is well aware of the intended and actual impact on the incentives of firms of the approach to fining that has been adopted by the UK and EU authorities, and I don't know how familiar the Tribunal is with this, but the relevant fining guidelines are at tabs 10 and 18 of authorities bundle I, and I refer in particular paragraphs 4 and 1.4 which emphasise the intended deterrent effect of fines in relation to undertakings.

Then thirdly we say that Ofcom also chose to exclude from its market analysis the realistic constraints that were already acting on BT because of the regulatory regime that had been in place since 2010, based on a combination of FRAND and guidance indicating that Ofcom would apply that condition as a form of margin regulation.

Ofcom appears to suggest at paragraph 78 that the FRAND condition that was in place from 2014 was in some way different from the FRAND condition that was in place from 2010. I must confess, there is no reference given and we found that a difficult submission to make, and in particular we found it surprising that Ofcom seemed to be implying that it was content to have no VULA margin regulation in place for a period of almost nine months, or a quarter of the entire market review period, from June 2014 to March 2015, but then to follow it up with an intensified margin regulation of the kind that they put in place at that time.

We say the reality of the situation is that the same regulatory system remained in place from 2010 to 2015, ie that BT was subject to a FRAND condition limiting its pricing freedom throughout the period, and that it is an error of law for Ofcom to have ignored that fact in its market analysis in this case, and I have already shown you the graph indicating how things were going in the market over the last two years of that regulatory regime.

We say there is nothing in the CRF or in EU law that justifies Ofcom's unrealistic and theoretical approach. We say that, on the contrary, not only the guidance of the Court of Justice in cases such as Tetra Laval, but also the guidelines in relation to market definition and market analysis all emphasise the need for a realistic economic approach. So, for example, the bundle includes at tab 6, page 10, paragraph 35 of the Commission guidelines, and at paragraph 8 of some further guidelines, tab 8, page 80, the need for a realistic approach, and we say that the same approach was adopted in the RegTP case which is

referred to by the Court of Appeal in its Hutchison case, in particular at paragraphs 22 to 23, and we say there is nothing in the Commission decision or that Court of Appeal case that suggests that Ofcom is permitted, still less required, to take an unrealistic or theoretical approach to the setting of regulatory conditions.

So the references to those two cases, it is authorities bundle II, tab 35, and 3.44, and we say that, as in other respects, Ofcom is confused on this issue. We say that Ofcom has misunderstood the logic behind the point, but when you conduct an overall analysis of whether a market is or is not competitive and whether there is an undertaking with significant market power on that market, which is the article 16 analysis for the framework directive, or the section 79 or 80 analysis under the Act, any SMP regulation currently in place should be ignored, and the recommendation I've referred to at authorities bundle I/8/80 paragraph 8, makes that very point.

We say that is obviously a sensible approach and we have given the analogy of a prisoner being considered for release from prison. We say it would be ridiculous to assess that issue by reference to his or her behaviour while in custody. The relevant question would be: what would happen if you let him out, and likewise, the same: what would happen if you withdrew SMP regulation.

We say that's all the so-called modified greenfield approach amounts to. It is not a mysterious piece of Euro jargon, it is simply a sensible and realistic approach to adopt when considering whether or not the market is competitive and SMP regulation can be relaxed.

We say that in the present case, as the Tribunal itself determined in its first ruling, the issue is in a much narrower compass. BT is not arguing on this appeal either that Ofcom was wrong to find that the wholesale supply of LLU or VULA is not effectively competitive, or that all SMP regulation should be withdrawn from that market. That is not any part of BT's case.

On the contrary, BT has made it clear throughout that it is content to abide by the ongoing regulation; ie the SMP conditions imposed in 2014, maintaining the 2010 FRAND approach; the terms of the 2005 undertakings, and the constraints of competition law generally. We say that Ofcom's deliberate decision at paragraphs 3.59 and 3.78, to exclude consideration of all of those regulatory conditions when considering any enhanced price control, is a clear error of law and is a fatal defect in the decision, both as a matter of law and as a matter of fact.

We say it is not simply a technical defect that Ofcom remedied in another part of its reasoning. We say both as a matter of law and as a matter of substance, Ofcom couldn't

properly determine the issue of relevant risk without taking realistic account of all relevant constraints.

So we say overall that Ofcom's approach to regulation in this case is based on two important fallacies. First, the point I have just mentioned, the modified greenfield approach, where we say that the true position is that all regulatory constraints are, in principle, highly relevant to a realistic market analysis. They are only to be excluded in limited circumstances where the question is whether or not those constraints are still needed or can be withdrawn.

We say that the suggestion that any defect in the market analysis was remedied at a later stage is also mistaken. So on that point, we would say that Ofcom was required to show that there was a realistic risk of BT engaging in a margin squeeze by reference to the real world conditions prevailing in the absence of the VULA condition.

MR. ALLAN: Could you just elaborate why you say that, as a matter of substance, Ofcom's consideration of the need for enhanced price control at a later stage in the process makes a difference to the outcome?

MR.THOMPSON: Well, as a matter of substance, we would say that legally they didn't do their jurisdictional task. As a matter of substance, I did think about an analogy, but before I embark on the analogy, I will give you the answer of substance.

As I've identified, there are essentially three classes of restraint: there's the existing FRAND, there's competition law, and there are the undertakings. I think in relation to FRAND and competition law, Ofcom says: well, it doesn't matter because once we decided there was a -- even if we did it on a wrong basis, once we decided there was a risk, we considered whether or not competition law and FRAND, either individually or in combination, would be sufficient to address that, so I think the fault line for Ofcom really is that there is no reference to the undertakings or the functional separation at either stage.

So if there was any -- even if there were certain conditions, so, for example, SMP conditions, and you say: well, we do discount those on a modified greenfield basis, which I say is wrong, then you still need to take account of competition law and functional separation in the undertakings.

They didn't take account of competition law at the first stage. We say that was wrong. But on any view they didn't take account of the BT undertakings at either stage, so in substance they only looked at the combination of FRAND and competition law. I think that's the highest they can put their case.

MR. ALLAN: What I am trying to grasp is, in relation to competition law and FRAND, which they have considered, to what extent in substance -- how, in substance, you say it makes

a difference to their assessment that they did it at the section 4 stage rather than the section 3 stage of the statement?

MR.THOMPSON: Well, I think we tried to put it in our pleadings. We say if they didn't get to the section 2 stage because there was a legal flaw at stage 1, then they lacked jurisdiction to impose the condition. 88.1(a) wasn't satisfied.

MR. ALLAN: I understand the argument as a matter of law.

MR.THOMPSON: Yes.

MR. ALLAN: What I am trying to grasp is how, at the end of the process, it makes a difference as to the point at which they do make the consideration, assuming, for the sake of this discussion, that the consideration is adequate. I understand you would dispute that.

MR.THOMPSON: Yes.

MR. ALLAN: But just so that I can grasp --

MR.THOMPSON: Can I give you my analogy, which is the furthest I've got to in terms of getting the thing clear.

We say suppose a local council -- we have moved out of the prisoners and we are now to something somewhat more, in a sense, realistic, because it is not a matter of crime or punishment, it is a matter of regulation and incentives. Supposing the local council is considering installing a new set of pedestrian traffic lights on a street and there were three restraints in place already: a 20 mile an hour speed limit, speed bumps and a zebra crossing. So there are three forms of restriction in place. And we say that the obviously relevant question to ask would be whether, despite the effects of those three existing restraints, there is still a significant risk to pedestrians from speeding motorists that could in principle justify the additional measure. We say that is equivalent to the realistic question that Ofcom should have asked under 88(1)(a). We say that simple and intuitive question is very different from the question of whether if all those existing conditions were assumed to have been lifted, so it was assumed that cars could drive down that same street at 60 miles an hour, there was a risk to pedestrians that might then theoretically exist.

We also say it is very different from the question of whether, if you assume that cars might drive down that road at 60 miles an hour, putting in two of the three -- so, for example, a zebra crossing and some speed bumps -- would be a sufficient remedy for that risk.

We say if the risk doesn't exist at all, that's a crazy question to ask, and that if, in fact, the three constraints effectively eliminate the risk, it is bonkers to say: ah, but what about if cars were driving around at 60 miles an hour and you put in traffic lights and a speed bump, would that be enough? Then if you say no and said: well, let's put in traffic lights instead.

We would say that the first question is a simple and realistic question and we say it is the question that the Court of Justice requires to be asked, and which any sensible person would expect to be asked.

We say the second question is a counter intuitive and a complicated and a highly theoretical question that wouldn't naturally occur to anyone.

We say the third one might be relevant for a proportionality analysis, but if you were going to do it you would have to have all of the restrictions in, because if you only put in two of the three, then again that wouldn't really be a sensible way of addressing the question.

So that's where I have got to on the analysis, and I hope it illuminates the sort of unreality of what we are saying. If we are right, and BT is heavily constrained, then there isn't a risk of somebody driving down the road at 60 miles an hour and you don't need to worry about it. Whereas Ofcom has got into this strange mentality of saying: supposing you had this big, bad bear in the woods, would it be enough to do this and that, when in fact you have BT, which is a heavily constrained undertaking which Ofcom knows very well.

So we say the whole thing is just a theoretical nonsense. That's really what we are getting at. I have, perhaps, put it a bit high, but that is the gist of the point.

MR. ALLAN: All right.

MR.THOMPSON: So my third limb was the real margin squeeze, and we've obviously dealt with this to some extent in the pleadings and in the skeleton, but I will try and explain this in an intuitive way, and no doubt Mr. Bishop and Mr. Tickel will put a more sophisticated gloss on it in their evidence.

We say that the essence of the conduct that could, in theory, lead to an abusive margin squeeze is where a vertically integrated firm with SMP either raises its wholesale price while maintaining its retail price, or reduces its retail price without reducing its wholesale price. Those are the two possibilities. There are obviously various combinations and permutations. You could improve your retail offer without putting your price up and things of that kind. But the gist of it is you raise your wholesale price and maintain your retail price, or you reduce your retail price without reducing your wholesale price.

Now, in both those cases, retail competitors will face intensified price competition, reflecting the vertically integrated firm's own reduced margin.

So far as the firm itself goes, it might lose wholesale business share or gain retail business, or it might simply increase its wholesale profits or reduce its retail profits. We say none of those possibilities is intrinsically harmful to competition. In the first case, consumers benefit from the fact that the vertically integrated firm has kept its retail prices down,

despite an increase in upstream costs; and they will benefit even more if other competing firms also keep their prices down in response.

In the second case consumers receive a price cut, even though the firm has not reduced its input costs. Again, consumers would benefit even more if other competing firms responded with their own price reductions, and in fact one pretty much sees that; if you look at the side of any bus going around London, you will see exactly what's going on, and sometimes it is BT that leads and sometimes it is Sky.

We say the position therefore requires a complex evaluation of conflicting factors, which raises difficult questions of assessment, which we would say are analogous -- we would say closely analogous -- to the type of prospective analysis considered by the CFI and ECJ in Tetra Laval.

So questions such as: what are the circumstances in which such pricing conduct, despite its apparently beneficial impact on consumers and competition, might in practice cause consumer harm in either the short or the longer term? Then, secondly, what realistic likelihood is there of those circumstances arising on the actual facts of the case?

We say that the Court of Justice has considered this case for many years, going right back to 1989 or 1990 in the Akzo case, where the Court of Justice has considered various scenarios in other cases of retail price cutting, such as predatory pricing, and whether or not they could or would be anti-competitive despite their short term consumer benefits. The Court of Justice has essentially identified three possibilities. The first is if the firm deliberately intends to drive out its competitors as a matter of policy. If there is evidence of that, then that is treated as an abuse.

Secondly, if the firm sets its prices or margins so low that it fails to cover even its marginal or its average incremental costs.

The third one is, if neither of those possibilities is satisfied, the prices or margins are set between marginal and total cost, but there is evidence of adverse effects on consumers. One finds that in cases such as Teliasonera in relation to margin squeeze at paragraphs 41 and 42, that's at authorities II, tab 29; or I think more recently the Post Danmark case in relation to, I think, rebates at authorities II, 31, paragraphs 37 to 39 and 44, and we set out this in some detail in our pleading at paragraphs 29 to 36 of the amended notice of appeal.

So our complaint here is that Ofcom's market analysis and evidence goes no further than the initial possibility that BT might put its wholesale price up but maintain its retail prices constant, or reduce its retail prices without reducing its wholesale prices. One sees that in the passages that I showed you in the final statement.

Ofcom produces no evidence at all to support a finding that BT might engage in either the first or the second forms of abusive conduct, intentional exclusion or pricing below variable costs, and there is no substantial evidence as to the third form; namely that BT might set its margins at some higher level that had an anti-competitive effect.

Indeed, on its face, both the final statement and Mr. Matthew's statement appear to object to any narrowing of BT's retail margin, whether or not it constitutes even a formal or an arithmetical margin squeeze. The logic of the statements at 3.62 and 3.64 of the final statement would apply to any intensified price competition from BT.

But the possibility of retail price competition by BT, which is all it amounts to, can hardly be the basis for enhanced price regulation without raising a serious risk of consumer harm from reduced price competition generally. So that's the theoretical criticism we raise.

Then, as a matter of fact -- and here we rely heavily on Mr. Bishop's two reports -- we would say that Ofcom's assessment of BT's incentives is completely inadequate. Ofcom doesn't carry out any assessment of the relative costs and benefits that would be likely to accrue were BT to engage in an anti-competitive margin squeeze on the UK retail broadband market; nor does Ofcom assess the likely costs of regulatory intervention as against the likely benefits, and on this second point, contrary to Ofcom's suggestion at paragraph 100 of its skeleton, this second point has always been part of BT's case. I think I have said this already; at paragraph 86 of the amended notice of appeal, we refer to Mr. Bishop's report, section 6.

There is a further twist to this; is that it is an issue that Ofcom itself is very familiar with, indeed relied on in relation to its decision not to impose price controls on VULA last June. One finds that in the FAMR report itself. It may be worth just looking at that. It's at volume II of bundle III, tab 8. It is in section 12, which is the VULA specific section, at page 381. Although it is quite a substantial clip, it is only a proportion of the total report, and if one turns through to, I think it is the second or third, maybe, it is page 381; does the Tribunal have it?

This is their assessment of whether or not to set cost controls on the pricing of VULA. First of all, there is a risk of adverse effects if they didn't regulate, and that is obviously of interest.

Secondly, there is the risk of regulatory failure if we did, and that's the point I was referring to.

Thirdly, there is the impact on investment incentives, and the issue of regulatory failure is at page 383, paragraphs 12.138 and 139.

So they are saying that if they got it wrong, that would actually make things worse and impact on BT's incentives and that is, in substance, the point that Mr. Bishop makes and which Ofcom says took it by surprise.

So in relation to incentives, we say that the case isn't made out. In relation to effects, so the second limb of what we would call a real margin squeeze, we say there is recent EU authority, very recent, in fact, that evidence of prospective effects on competition must meet a standard of at least realistic likelihood -- and, in fact, the Court of Justice said, in response to a straight question, it must reach a standard of probability. One finds that in authorities bundle II, tab 34.

Some undertakings within the EU seem to have more attention than others, and Deutsche Post and Post Danmark seem to have a disproportionate appearance. Although I suppose the same could be said of BT, at least in the domestic sphere.

Anyway, this is another Post Danmark case and this was a case about rebates, and the point I was looking at is simply the question of anti-competitive effect, and you can see that towards the end of the clip. It is at page 11 of the electronic report. The gist of it is that the Tribunal -- it was a similar issue, actually, to the conglomerate merger point, but they found that certain types of rebate were ambiguous from a competition point of view and required proof of effect. Then the question was whether or not this type of effect needed to meet a standard of probability, and you will see that in 63, that there is a question about whether or not the anti-competitive effect of a rebate scheme, such as that at issue in the main proceedings, must be on the one hand probable, and on the other serious or appreciable.

Then at 65 there is reference to it:

> "The effect must not be purely hypothetical."

Then at 67, the Court of Justice says:

> "It follows that only dominant undertakings whose conduct is likely to have an anti-competitive effect on the market fall within the scope of article 82."

Then it concludes at 74, responding to the question asked, that:

> "Article 82 must be interpreted as meaning that in order to fall within the scope of that article, the anti-competitive effect of a rebate scheme operated by a dominant undertaking must be probable, there being no need to show it is of a serious or appreciable nature."

So they said as long as there was a probability issue, then given you are dealing with dominant firms, you don't have to show the scale of it but you do have to show probability.

So we say that that is entirely consistent with the case that we advance on the nature of

the evidence that's required in relation to effect. We say that there is no reason to apply any lower or different standard in relation to the prospective assessment of risk of harm in the analogous context of the imposition of price controls.

We say that it is consistent with the requirements that have been made clear by the ECJ in cases such as Tetra Laval, and by the Tribunal in cases such as Vodafone. We say that Ofcom's analysis falls well short of that standard. We say the entire analysis of BT's likely conduct is theoretical, and abstracted from reality; indeed, the empirical evidence on which Ofcom relies, primarily consisting of projected market shares, is entirely consistent with and, indeed, assumes vigorous competition on the merits.

We say, of course, that the position is made even more uncomfortable for Ofcom by the fact that the real and directly relevant evidence that we have is that it has very recently investigated BT's pricing on this very market and found there was no case of abuse to answer. We say that Ofcom offers no substantial evidence that anything has changed or might in future change that would be likely to lead to any different outcome between now and March 2017.

So we say they haven't shown a real risk. They haven't applied a realistic market analysis, and it isn't a realistic margin squeeze. They haven't applied the right test and they haven't produced the right evidence.

So, just to wrap it up, and it works out that the timing has worked out well, we say that section 88(1)(a) is to be construed in accordance with EU law, which defines both the concept of a margin squeeze and the correct approach, the assessment of prospective risk.

We say viewed against those standards, which reflect not only the legal position but also economic principle and statement of regulatory policy by Ofcom itself, Ofcom's margin analysis is not fit for purpose. It is a theoretical exercise that fails to consider properly, or at all, the complexity of this market and the realistic constraints operating on BT on that market, and I note that I haven't even mentioned the complexities inherent in bundling, but that's, no doubt, an issue that will emerge in the evidence.

In the terminology of the Tribunal in Vodafone, the analysis cannot withstand profound and rigorous scrutiny, and if it is to be suggested, it is not for BT or for its experts to remedy those clear defects in Ofcom's own homework.

The consequence is that Ofcom didn't establish its jurisdiction to impose it in enhanced price control, and as such, the VULA margin condition was imposed without jurisdiction. The prohibition in section 88(1)(a) applied and the condition must, therefore, be set aside.

Those are the points I had by way of opening, unless anyone behind me wants me to say

anything else? No, we have a blank. Everyone is looking forward to their lunch.

THE CHAIRMAN: Thank you very much. 2.00 pm.

(1.00 pm)

(The Luncheon Adjournment)

(2.00 pm)

Opening submissions by MR. HOLMES

MR. HOLMES: I shall divide my submissions into two parts. I will begin with the relevant legal framework and respond to BT's allegations of legal error against Ofcom. I will then consider Ofcom's reasons for its decision to set the VULA margin condition to show that the substantive analysis was not deficient in the ways alleged.

Mr. Thompson has already shown you some of the relevant legal provisions, but it is convenient to revisit these to explain our understanding of them as there are some differences of emphasis. The rules derive from European legislation, the common regulatory framework, and the Framework Directive lays down the structure of analysis that National Regulatory Authorities are required to follow when deciding whether to impose specific ex ante obligations on communications providers.

There are three specific stages of analysis: the first is to identify relevant markets. The key issue at this stage is to work out which products compete with one another on the same market and within what geographic area. This provides a basis for assessing the strength of the competitive constraints that apply to a given product.

The second stage of analysis is to consider whether the market, as defined, is effectively competitive or not. The market will not be effectively competitive if there is a supplier in the market which has significant market power or SMP. That is to say, the competitive constraints on the supplier are not sufficient to prevent it from acting in a way which is harmful to competition and, therefore, to end users.

The third stage of analysis only applies when the market is not effectively competitive. In that case, the National Regulatory Authority must impose remedies, and the legislation provides a toolkit of such remedies, as you were shown this morning, from which the authority must select the most appropriate remedies to deal with the lack of effective competition in the case at hand.

This case is concerned exclusively with the third stage of analysis. Ofcom defined the relevant market in a statement published in June 2014, and found that BT had significant market power, and BT accepts that this is so. The appeal is concerned, therefore, only with

whether Ofcom was entitled to impose a price squeeze remedy on the market when selecting which of the common regulatory framework toolkit of remedies to impose in order to address BT's significant market power.

If we turn to the Framework Directive, which is in authorities bundle I/2, recital 27 sets out the framework, or structure, that I have just outlined:

> "It is essential that ex ante regulatory obligations should only be imposed where there is not effective competition, ie in markets where there are one or more undertakings with significant market power, and where national and community competition law remedies are not sufficient to address the problem."

So an assessment of ex post competition law is therefore already taken into account when identifying markets that are not effectively competitive; that is to say, at the first two stages of analysis.

Turning to the substantive provisions, article 3, paragraph 1 requires --

MR. ALLAN: Sorry, Mr. Holmes, could I just clarify with you: you say that competition law is taken into account when determining the first two stages. By that you mean identification of the relevant markets and effective competition?

MR. HOLMES: Yes.

MR. ALLAN: So is it your contention that competition law is irrelevant to the remedy assessment?

MR. HOLMES: No, sir, it is, in my submission, relevant to the question of the proportionality of the remedies that are imposed, so when assessing what remedies would be proportionate to deal with the situation on a given market, it is relevant at that stage as at the previous stages, to consider what ex post competition law is able to achieve, and what ex ante remedies might need to be added into the equation.

MR. ALLAN: Are you drawing a distinction between proportionality and necessity?

MR. HOLMES: No, necessity is an element of proportionality, sir.

MR. ALLAN: Okay.

MR. HOLMES: So the substantive provisions, beginning with Article 3. Article 3, paragraph 1, requires Member States to assign tasks to the National Regulatory Authority, and Ofcom is the competent body in the UK. Article 3, paragraph 3(c) over the page, requires:

> "Member States shall ensure that National Regulatory Authorities take utmost account of opinions and common positions adopted by [a body called] BEREC ..."

The Body of European Regulators for Electronic Communications, that's the umbrella

group of national regulators:

> "... when adopting their own decisions for their national markets."

And there is a connected provision at Article 19, paragraphs 1 and 2. As well as BEREC's guidance, the Commission also now has power where it finds divergences in the implementation by the National Regulatory Authorities of the regulatory tasks specified in this directive, and the specific directives and where that may create a barrier to the internal market to issue a recommendation, or a decision, on the harmonised application of the provisions in this directive, and the specific directives, in order to further the achievement of the objectives set out in article 8, and as you will see from the second sub paragraph of article 19, paragraph 2:

> "Member States are required to ensure that national regulatory authorities take the utmost account of those recommendations in carrying out their tasks.

In this context, there is both BEREC guidance and a relevant commission recommendation to which Ofcom was required to have regard, and I will show you those.

Turning back in the Framework Directive to chapter 4, one finds here the arrangements for identifying the relevant market for assessing whether there is significant market power and for imposing remedies where that is the case. Article 14 defines the concept of significant market power, in article 14.2, in a definition that will be well familiar to ex post competition lawyers:

> "An undertaking shall be deemed to have significant market power if it enjoys a position equivalent to dominance, that is to say, a position of economic strength, affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."

The competitive constraints are, therefore, a matter of degree. The dominant operator must be able to behave to an appreciable extent independently of competitors, customers and consumers. The test does not require the absence of any constraints, which will rarely be the case in a market.

Article 15 primarily concerns the first stage of analysis, market identification, and article 15.1 makes provision for the Commission to publish a recommendation identifying product and service markets, the characteristics of which may be such as to justify the imposition of regulatory obligations set out in the specific directives.

Article 15.3 requires NRAs to define relevant markets appropriate to national circumstances, taking that recommendation into account.

Article 16 concerns the second and third stages of analysis; that's to say, market analysis for

SMP and selection of remedies.

Article 16.1 requires NRAs to carry out an analysis of the relevant markets they have identified, taking utmost account of guidelines issued by the Commission.

Article 16.3, as you saw this morning, provides that:

> "If markets are effectively competitive, no specific regulatory obligations may be imposed."

Article 16.4 provides that:

> "If a market is not effectively competitive, the National Regulatory Authority is required to identify undertakings with significant market power and to impose specific regulatory obligations upon them."

Those obligations are those referred to in Article 16.2 of the Framework Directive, and there you will see a reference to the significant market power obligations in the Access Directive, which can be imposed by virtue of Article 8 of that directive.

BT says that regulation must be imposed with care as a last resort and this is, of course, true, but by the time that one reaches the third stage of analysis, one has already concluded that there is a lack of effective competition, and the need for caution is to some extent reflected in the common regulatory framework by the requirement to find significant market power as a precondition for the imposition of specific ex ante obligations.

The third stage of analysis under the common regulatory framework scheme is then fleshed out in the Access Directive which is at tab 3 of the authorities bundle. Mirroring the requirement in article 16.4 of the framework directive, one sees at article 8, paragraph 2 of the access directive, the requirement:

> "Where an operator is designated as having significant market power on a specific market to impose the obligations set out in Articles 9 to 13 of this directive as appropriate."

So National Regulatory Authorities must impose one or more of those obligations to address the problems that are considered to arise.

The relevant obligations are, as you were shown by my learned friend this morning, obligations of transparency under Article 9, obligations of non discrimination under Article 10, obligations of accounting separation under Article 11, network access obligations under Article 12, and price control and cost accounting obligations under Article 13.

National Regulatory Authorities will, of course, often apply a combination of remedies from this toolkit in relation to the lack of effective competition on a particular market. The obligations can play a complementary role. So, for example, transparency and accounting

separation may facilitate a price control and cost accounting obligation and an obligation of network access may require rules against discrimination, where the dominant operator is vertically integrated and so on.

The VULA product at issue in this case was created by regulation through a network access obligation in order to ensure the availability to other communications providers of a wholesale product enabling them to provide retail superfast broadband in competition with BT, and it is subject to non discrimination remedies.

Prices are also controlled to a degree at wholesale level, but only by means of a fair, reasonable and non-discriminatory obligation.

The condition under appeal falls under article 13.1, which provides in relevant part that:

> "A National Regulatory Authority may impose obligations for cost orientation of prices for the provision of specific types of interconnection and/or access in situations where a market analysis indicates that a lack of effective competition means that the operator concerned may apply a price squeeze to the detriment of end users."

My learned friend says that a price control remedy is a particularly onerous obligation, and that a high threshold must be met, but this submission needs to be considered in the light of recital 20 in the preamble of the Access Directive which explains Article 13. If I could just ask the Tribunal quickly to refresh their memory of the first part of Article 20.

Mr. Thompson showed you the definition of a market squeeze, beginning with the words "In particular", but it is the prior two sentences that I would ask you to read. **(Pause)**.

So as this recital makes clear, there are a range of different types of price control, ranging from the relatively light touch to the heavier kind of cost plus price control, which is imposed in some markets to control the absolute level of prices at the wholesale level and the costs that can be efficiently recovered.

The recital also explains, as Mr. Thompson has shown, what a price squeeze is in broad terms. It notes that:

> "... operators ... should avoid a price squeeze whereby the difference between their retail prices and the interconnection prices charged to competitors who provide similar retail services is not adequate to ensure sustainable competition."

Now, this type of remedy does not restrict a dominant operator in the same way as a cost plus price control. It doesn't impose a control upon the absolute level of prices, either at the wholesale or the retail level. It doesn't determine what costs may be efficiently recovered.

The operator may set the wholesale price without constraint, and as regards the retail price, the requirement is to maintain a sufficient level of profitability to ensure that efficient operators can compete effectively.

There is a further point about the meaning of margin squeeze, which it is convenient to pick up now, which one finds set out in a guidance document issued by the predecessor to BEREC, the ERG, or European Regulators Group, which is at tab 12 of authorities bundle I, if I could ask you to turn there now.

At paragraph 1, this document explains that:

> "A margin squeeze is a situation where a vertically integrated firm with market power and a key upstream market, supplies rival firms in associated downstream markets and sets prices for the input and the downstream service in a way that renders unprofitable the activities of its competitors in the retail market."

At the end of paragraph 6, in the final sentence, a distinction is drawn between ex post competition law and ex ante regulation, which seeks the more ambitious goal of promoting competition by facilitating entry into those markets, meeting the three criteria test. That's a test for defining relevant markets, which I will show you in a moment. At paragraphs 15 and 16, one sees a distinction between margin squeeze and other anti-competitive practices. As explained there, the key focus is on the difference between the upstream and the downstream price, not on whether the prices are excessive, discriminatory or predatory, per se. In other words, the focus is not on the intrinsic fairness of one particular price, rather on the effect of the combination of those two prices.

In paragraph 16, a distinction is drawn between two types of margin squeeze. One does involve discrimination, when a vertically integrated operator charges its downstream rivals a higher price than it charges to its own downstream operation, but the classic margin squeeze is the one set out in (ii):

> "A non-discriminatory margin squeeze when a vertically integrated undertaking raises the price of the upstream input both to downstream rivals and its own downstream operation. Note that a non discrimination obligation imposed on wholesale prices should limit the possibilities of (i)."

So the point being made here is that margin squeeze need not involve any discrimination in terms of the prices charged at wholesale level to downstream operators on the one hand and the dominant operator's own downstream operation.

MR. ALLAN: Could I just take you back to paragraph 6 of that document.

MR. HOLMES: Yes.

MR. ALLAN: Do you read "promoting competition by facilitating entry" as synonymous with "ensuring sustainable competition" in recital 20 of the Access Directive?

MR. HOLMES: Sir, it is a good question. I am not sure it is necessarily one which arises in this case. It goes rather to a particular remedy imposed. In this context I am not suggesting that Ofcom has imposed the test in order to promote market entry other than for the purposes of ensuring sustainable competition, if that answers your question.

MR. ALLAN: Thank you.

THE CHAIRMAN: What is this document, exactly?

MR. HOLMES: It's a document produced by the predecessor to BEREC, the European Regulators Group. I am not suggesting that it has any binding force on Ofcom or that it is even a document that Ofcom is obliged to take account of. I am showing it to you simply because it provides a clear statement of the difference between margin squeeze on the one hand and other types of potentially anti competitive conduct, namely discrimination on the one hand and predation on the other.

Just to complete the submission in terms of the distinction, the reason why no discrimination is required is because you can achieve a price squeeze as a dominant firm while providing the upstream input at the same price and on the same terms to both your own operations and the operations of your retail competitors. The anti-competitive effect that may arise is because of the difference between that upstream price and the downstream retail price at which your own downstream operations sell the retail product, which incorporates the upstream input. So that is why discrimination isn't a necessary feature of margin squeeze at the wholesale level.

Equally, predation is not a necessary feature of a margin squeeze when one considers prices across the whole of the dominant operator's activities, and that is because the dominant operator enjoys both profits upstream and profits downstream. So if the margin squeeze is affected by increasing the wholesale price, there may be a loss at the retail level, but the activity is still profitable on an end to end basis, that's to say across the whole of the dominant operator's activities.

If I might return to the Access Directive, I should deal with Article 13A, to which Mr. Thompson referred this morning. That is back in tab 3 of authorities bundle I on page 16.

As was explained this morning, this provides for a long-stop functional separation remedy where it appears that other types of remedy are not operating effectively. Now, in the UK context, BT's undertakings impose certain organisational constraints along the same lines as

Article 13A. They were introduced in 2005 and Article 13A was brought in later by amendment to the Access Directive in 2009, so no provision was made at the time equivalent to that which is now contained in Article 13A.

There are two points to note in relation to Article 13A. The first is that Article 13A, paragraph 5 makes clear that functional separation is not necessarily incompatible with SMP obligations being maintained under Articles 9 to 13. They may still be needed. So one sees at paragraph 5:

> "An undertaking on which functional separation has been imposed may be subject to any of the obligations identified in Articles 9 to 13 in any specific market where it has been designated as having significant market power in accordance with Article 16 of ….[the] (Framework Directive)."

So there is still scope following functional separation to impose specific remedies.

The reason for that can be seen from the recitals that are relevant to this new provision, to which you were taken this morning, but it would be useful just to revisit those. Those are the recitals to the 2009 directive, which affected the amendments to the Access Directive, which introduced Article 13A to the Access Directive, and those recitals are found at tab 5 of authorities bundle I.

You saw this morning, recital 61. The purpose of functional separation is explained clearly in the first two sentences of recital 61 as being:

> " ... to ensure fully equivalent access products."

This is often described, as we will see later, as an equivalence of inputs requirement. So to try and avoid discrimination, including non price discrimination, you impose a requirement that the downstream operations of the dominant operator consumes the same products, the same designations of products, the same design of product, at the same price as the wholesale products which are provided to retail rivals. This is a guard against discrimination, and this can be supplemented by a requirement of functional separation in order to ensure that there isn't discrimination of this kind in the provision of the wholesale inputs by insulating the upstream provider within the dominant operator of those essential wholesale inputs. But the focus is very clearly on non discrimination, in my submission.

In recital 62, another important point about the implementation of functional separation. It should not prevent appropriate coordination mechanisms between the different separate business entities in order to ensure that the economic and management supervision rights of the parent company are protected.

So a functional separation remedy will not necessarily limit coordination mechanisms to

remove the scope for strategic action across the group, and that is obviously relevant when assessing whether there are -- whether the functional separation remedy is really apt to avoid strategic incentives to benefit the group at the expense of competitors across the whole of its operations.

PROFESSOR. MAYER: Can I just clarify?

MR. HOLMES: Yes, sir.

PROFESSOR. MAYER: Are you saying that the only significance of functional separation is in terms of discrimination or non discrimination, and that there are no other effects on incentives within the organisation?

MR. HOLMES: No, sir, I wouldn't make so bold a submission. You would need to consider the particular arrangements of functional separation in a given case to see how much freedom they provide for influencing the commercial decision-making of the upstream part of the dominant operator's operations, and there will be evidence -- there is already evidence before the Tribunal, and the Tribunal will hear evidence over the coming days, about how functional separation under the undertakings operates in practice.

My submission for present purposes is simply that the focus of introducing a functional separation remedy is to assist with equivalence of inputs. The two go hand in hand, and you see that from recital 61.

There is also relevant guidance at European level, which Ofcom is required to take into account. Now, as regards market identification, there is the Commission recommendation on relevant products and service markets, published pursuant to article 15 paragraph 1 of the Framework Directive, and although this relates to a prior stage of the analysis, and not the stage that the Tribunal is concerned with, it does, in my submission, shed some relevant light on the issues that the Tribunal does need to consider, and that is at tab 7 of the authorities bundle.

Recital 2 explains the purpose of the recommendation to identify those products and service markets in which ex ante regulation may be warranted in accordance with Article 15 paragraph 1 of the Framework Directive.

Then at recital 5, the Commission explains that it has applied three criteria in identifying the relevant markets. It has first considered whether there are high and non transitory barriers to entry, for example, the expense and difficulty of building a network that connects to all the residential premises in a Member State; second, this needs to be supplemented with a forward-look assessment of forthcoming developments to see whether there are factors which might lead to the emergence of effective competition, and this is particularly

important because, in the words of recital 5, of "the dynamic character and functioning of electronic communications markets".

Then, thirdly, in the final sentence:

> "Application of competition law alone would not adequately address the market failures concerned."

The third criterion is then expanded upon at recital 13, which explains, in the final sentence, that:

> "Competition law interventions are unlikely to be sufficient where the compliance requirements of an intervention to address a market failure are extensive or where frequent and/or timely intervention is indispensable."

Those are the types of consideration that it is relevant to take into account when deciding whether ex post competition law is enough. Those are the ones that the Commission has considered in identifying the markets identified in this recital.

Then you see at recital 17:

> "The markets listed in the annex have been identified on the basis of these three cumulative criteria by the Commission."

So the Commission has done the relevant work and has concluded that:

> "There are high barriers, effective competition is unlikely to emerge, and competition law is insufficient on its own to ensure effective competition."

Now, NRAs can identify additional markets beside those in the annex, but must do so by reference to the three criteria.

At recital 18 the point is made that:

> "The National Regulatory Authority should still consider whether there is SMP in relation to the markets identified and, if not, there will be no need for regulation.

You then have the recommendation which follows the preamble, and Article 1 makes clear that:

> "In defining relevant markets appropriate to national circumstances, national regulatory authorities should analyse the products and services markets identified in the annex to the recommendation."

You see in the annex various markets are identified. The relevant market for the purposes of VULA is market 4:

> "Wholesale physical network infrastructure access, including shared or fully unbundled access at a fixed location."

Now, with effect from October 2014, the 2007 recommendation has been replaced with a new recommendation on broadly similar lines. Now, that post dated the market analysis that Ofcom undertook in finding SMP, but the WLA market, which was market 4, is still identified as a market susceptible to ex ante regulation by reference to the same three criteria. It is now defined as market 3A.

There is also guidance of very specific relevance in the present context concerning the appropriate regulation of superfast broadband. If you could turn to authorities bundle I, tab 8, there is there a recommendation issued by the Commission pursuant to article 19.1 of the Framework Directive, of which, as the Tribunal have seen, National Regulatory Authorities are required to take utmost account.

The title shows that it is about non discrimination obligations and costing methodologies in relation to broadband. There is then a very lengthy preamble.

Recital 3 makes clear that the recommendation is concerned in part with NGA networks, Next Generation Access networks; that is to say, the fibre networks which are used to provide products like VULA.

Three objectives of the recommendation are then identified in the sentence beginning "The present recommendation", about halfway through the recital:

> "The first being to ensure a level playing field through the application of stricter non discrimination rules."

As we will see, the focus here is upon equivalence of inputs, dealing with the problem of price discrimination or non price discrimination which functional separation is designed to reinforce.

Secondly, to establish predictable and stable regulated wholesale copper access prices, so that aspect is relevant to local loop and bundling rather than to products like VULA which are supplied over Next Generation Access networks.

Then, thirdly:

> "To increase certainty in the circumstances which should lead to the non position of regulated wholesale access prices for NGA services, increasing legal and regulatory predictability in this manner should further help to trigger the investment needed in the near to medium term future."

So the aim is to secure a regulatory environment which is predictable for operators by specifying the circumstances in which regulators like Ofcom decide not to impose regulated wholesale access prices. That's to say the type of more intensive, cost plus price control regulation, which is also permissible under Article 13 of the Access Directive.

Recital 5 explains that there are significant inconsistencies that still exist across the Union in the application of non discrimination obligations under Article 10 and of price control and cost accounting obligations under Article 13 in both the market 4, which is the market present relevance and the wholesale broadband access market, market 5, which is for downstream wholesale products of a more managed kind.

Recital 7 explains that:

> "Regulatory obligations regarding access pricing imposed under Article 13 of Directive 2002/19 in markets 4 and 5 vary considerably across the Member States… although such variations are not justified by underlying differences in national circumstances."

And at recital 8, the conclusion is drawn that:

> "The significant variations in the regulatory approaches chosen by NRAs with regard to these two remedies hold back the development of the internal market for electronic communications networks and services and thus hamper potentially significant welfare gains in the overall economy. Such variations create regulatory uncertainty and result in a lack of consistent access regulation, thus limiting opportunities to realise economies of scale."

This is the problem which this recommendation aims to achieve. Then at recital 9:

> "Where SMP is found within Articles 4 and 5, an appropriate set of remedies should be applied in accordance with the provisions of the Access Directive."

There is then a discussion of these three types of regulation, beginning with the non discrimination obligation, and it is worth looking at that briefly, given that reliance is placed in this case on the equivalence of inputs obligations to which BT is subject, both under SMP regulation of VULA, and under the undertakings.

You will see that equivalence of inputs is explained -- well, first of all, recital 12 identifies a problem:

> "One of the main obstacles to the development of a truly level playing field across access seekers being discrimination regarding quality of service, access to information, delaying tactics, undue requirements and the strategic design of essential product characteristics."

In other words, price and non price discrimination.

At recital 13 in the second sentence:

> "The Commission considers the equivalence of inputs is in principle the surest way to achieve effective protection from discrimination as access seekers will

> be able to compete with the downstream business of the vertically integrated SMP operator using exactly the same set of regulated wholesale products at the same prices and using the same transactional processes."

So equivalence of inputs then is about addressing price and non price discrimination and, as we have seen, a margin squeeze does not require or involve discrimination at the wholesale level.

Turning forward you see then from recital 25, the costing methodology, which is in relation to copper access.

Then above recital 49, you see the heading "Non imposition of regulated wholesale access prices on NGA networks."

We say this is directly relevant to the case in hand, because Ofcom decided not to impose regulated wholesale access prices in respect of the VULA wholesale input, and in doing so, it was required to take utmost account of the recommendation which is set out -- the recommendation which is here set out, which is described and justified in these recitals.

Recital 49 notes that:

> "Due to current demand uncertainty regarding the provision of very high speed broadband services, it is important in order to promote efficient investment and innovation to allow those operators investing in NGA networks a certain degree of pricing flexibility."

This is exactly what Ofcom has decided to do in relation to the wholesale VULA input. It didn't impose price regulation, cost plus price controls in order to allow flexibility, partly because of demand uncertainty.

At recital 50, the recommendation states that:

> "In line with points 48 to 57...."

That's points in the recommendation itself, remember we are still in the preamble here.

> "... to prevent such price inflexibility leading to excessive prices in markets where SMP has been found, it should be accompanied by additional safeguards to protect competition. To this end, the stricter non discrimination obligations, ie equivalence of inputs and technical replicability, should be complemented by guaranteed economic replicability of downstream products in conjunction with price regulation of copper wholesale access products."

So there are a range of conditions which it is proposed should be in place. The recommendation is that they should be in place when regulating in the absence of an upstream control of wholesale pricing, and one of these is an economic replicability test,

and this is described as seeking to prevent excessive prices from arising at the wholesale level.

Now, just to cash that out, there is an obvious concern with a price squeeze, as regards price squeeze. Where you have no regulation at wholesale level, there will be nothing to stop a dominant operator from achieving a price squeeze which might harm downstream competitors by increasing the level of its wholesale charges, because the wholesale prices aren't capped. They can go up. This would, therefore, allow a profitable price squeezing strategy where the profit is taken at the upstream level while downstream competitors are disadvantaged because of the amount of margin that's allowed to them at the retail level. So if you don't have a control at the wholesale level, there is a concern that it would be easy to engage in a margin squeeze profitably, and the economic replicability test aims to address that.

The economic replicability test referred to here is nothing other than a price squeeze test. You see this over the page at recitals 62 to 65. So in recital 62, starting in the second sentence, you see that:

> "The purpose of the economic replicability test is to ensure that SMP operators do not abuse this pricing flexibility in order to exclude (potential) competitors from the market."

That, I think, is a reference to either actual or potential competitors, hence the "potential" appears in brackets.

> "The guidance provided in annex 2 is limited to the application of point 56."

We will come to that in a moment.

At recital 64 there is a description of the test:

> "NRAs shall ensure that the margin between the retail price of the SMP operator and the price of the NGA wholesale input covers the incremental downstream cost and a reasonable percentage of common costs."

Then mid-way through the following sentence:

> "A lack of economic replicability can be demonstrated by showing that the SMP operator's own downstream retail arm could not trade profitably on the basis of the upstream price charged to it competitors by the upstream operating arm of the SMP operator."

That is, of course, the classic equally efficient operator margin squeeze test.

Then in recital 65:

> "Where specific market circumstances apply such as where market entry or

expansion has been frustrated in the past, NRAs may make adjustments for scale to the SMP operator's costs in order to ensure that economic replicability is a realistic prospect. In such cases, the reasonably efficient scale identified by the NRA should not go beyond that of the market structure with a sufficient number of qualifying operators to ensure effective competition."

So this is a type of margin squeeze test, and as we saw, one of the conditions for removing, or for not imposing a cost plus price control at the wholesale level under this recommendation is to impose margin squeeze and economic replicability test at the downstream level.

Then recitals 66 and 67 concern how this economic replicability test is to be enshrined in regulation. Recital 66 explains that:

"The NRA should set out and make public in advance in its adopted measure following a market analysis [that is to say the measure of imposing remedies under the CRF] the procedure and parameters it will apply when running the ex ante economic replicability test."

And at recital 67:

"The economic replicability test set out by the NRA in advance should be adequately detailed and should include as a minimum a set of relevant parameters in order to ensure predictability and the necessary transparency for operators."

The recommendation itself then begins after the preamble. The aim is at point 1:

"To improve the regulatory conditions needed to promote effective competition, enhance the single market for electronic communications network and services, and foster investment in NGA networks."

At point 5, the relevant products on markets 4 and 5 to which the recommendation applies are identified and they include at (iv), towards the end of the point:

"Non physical or virtual network access."

This is the type of access product that the VULA, Virtual Unbundled Local Access, is.

The non imposition of regulated wholesale access prices on NGA networks are covered from point 48, and point 49 is the relevant one for present purposes:

"The NRA should decide not to impose or maintain regulated wholesale access prices from passive NGA wholesale inputs for non physical or virtual wholesale inputs offering equivalent functionalities pursuant to Article 13 of Directive 2002/19/EC [that is the price control power] where in the same measure, the

> NRA imposes on the SMP operator non discrimination obligations… that are consistent with …equivalence of inputs, …technical replicability..."

And at C:

> "Obligations relating to the economic replicability test as recommended in point 56."

Point 56A then sets out the parameters that the economic replicability test should cover, specific guidance about such things as the relevant downstream costs, the relevant cost standard, the inputs concerned, the relevant retail products and the time period for running the test.

Point 56B notes that:

> "The test is different from and without prejudice to margin squeeze tests that may be conducted under ex post competition law."

Point 58 notes that:

> "There may be other circumstances in which NRAs can decide not to impose regulated access prices for NGA wholesale inputs, depending on the demonstration of effective equivalence of access and non competitive conditions."

So I am not suggesting that recital 49 is the only possible way in which you could avoid imposing a cost plus obligation, but there is nonetheless a clear recommendation as to the circumstances in which it would ordinarily be appropriate to remove cost plus, or not to impose cost plus regulation at the wholesale level of Next Generation Access networks, and that includes an economic replicability test which is a margin squeeze test.

In annex 2 you have details of the ex ante economic replicability test, and you see in the opening paragraph the purpose of the test is to assess whether the margin between the retail price and the relevant retail products and the price of the relevant NGA-based regulated wholesale access inputs covers the incremental downstream costs and the reasonable percentage of common costs."

At point 1, this really goes to the design of the issues that were before the CMA, but:

> "NRAs may make adjustments for scale to the SMP operator's downstream costs in order to ensure that the economic replicability is a realistic prospect."

So BEREC has been monitoring the measures put in place by National Regulatory Authorities in response to the recommendation and as at December 2014, a little over a year after the recommendation, BEREC published the results of a survey of all National Regulatory Authorities which showed that 58 per cent had already put in place a margin

squeeze test, with the remaining 42 per cent described as "not having implemented yet".

There is one further piece of guidance that Ofcom is required to take into account and that is the BEREC common position on best practice in remedies. Now, the one which has been provided in the authorities bundle unfortunately relates to the WBA rather than the WLA market, what was market 5 instead of what was market 4.

We included the correct common position in a supplemental hearing bundle, hearing bundle volume IV, which I hope you should have. This is a BEREC common position on best practice in remedies on the market for wholesale physical network infrastructure access at a fixed location, that's market 4.

On page 3 you will see that there is a table set out with best practice remedies indicated. In the left-hand column there is the objective, in the middle column there is the competition issue which arises frequently and then a best practice remedy is identified. On page 18, the objective of fair and coherent access pricing appears. Page 19 there is a competition problem which arises frequently, which is identified, namely SMP operators may margin squeeze, and an important additional point in the final sentence of the text underneath that heading:

> "Alternative operators may face uncertainty regarding the principles and methodology for the assessment of margin squeeze, which in turn could result in complaints not being resolved quickly".

So there is a concern about having a margin squeeze test which doesn't provide sufficient detail to enable both the dominant operator and competitors to understand whether or not the margin squeeze test is being complied with.

Then in the final column on page 20, there is best practice remedy number 49:

> "NRAs should put in place obligations preventing SMP operators from engaging in margin squeeze."

At BP 49D:

> "The chosen principle and methodology for the assessment of the margin squeeze should be made known in advance, eg by advance publication."

So it's not enough to say: thou shalt not margin squeeze, according to BEREC's best practice guidance, it's necessary to provide principle and methodology to assist in the subsequent application of the test.

This, in my submission, is relevant to the suggestion that a FRAND obligation -- that's to say a simply obligation to price on fair, reasonable and non-discriminatory terms, would be a satisfactory way of addressing a relevant risk.

Now, in this case, BT accepts that a FRAND obligation is a legitimate obligation to impose, and we say in those circumstances, the relevant risk test must be met, and it is clear from the best practice guidance, which Ofcom is required to respect, that the chosen principle and methodology should be set out in the margin squeeze condition, as Ofcom did.

Mr. Thompson has shown you the domestic legislation implementing Article 13 of the Access Directive, namely section 88 of the Communications Act. I don't need to revisit that.

Under section 88(1)(a), Ofcom must identify a relevant risk of adverse effects arising from a price distortion and under section 88(3), there is such a risk if the dominant provider might so impose a price squeeze as to have adverse consequences for end users of public electronic communications services.

I should, however, say a word about the appeal process. The appeal is on the merits, and we have referred in our skeleton argument to a recent and comprehensive account of what this means, which was given by the Tribunal in the pay TV appeals. BT rightly pointed out that that was in the context of an appeal under a different statutory provision, section 316, which refers back to sections 192 to 195, the same standard of appeal applies, namely an appeal on the merits, and if I could just take you to our skeleton argument, the passage from the Court of Appeal in which this test is adopted shows that the test is equally applicable in the present context. So that's at tab 2, paragraph 16. So BT v Ofcom, a section 192 appeal against a dispute determination, so squarely within the common regulatory framework.

The Court of Appeal stated that those principles should similarly guide our approach to the challenges to the determination:

> "In particular, since it has been repeatedly emphasised the Tribunal is not a second tier regulator, the fact that the Tribunal might have preferred to give different weight to various factors in the exercise of a regulatory judgment would not in itself provide a sufficient basis to set aside the determination made by Ofcom."

I do apologise, the passage that I was just referring to is in paragraph 17 rather than paragraph 16 of my skeleton argument.

Two further points in this connection: first there was a suggestion by BT that the criticism of Ofcom's analysis of relevant risk amounted to allegations of errors of fact. Now, we disagree with this suggestion: the assessment of future risk is not a finding of fact, it is an evaluative exercise involving careful and difficult regulatory judgments in a dynamic and fast-moving industry and it needs, in our submission, to be approached accordingly.

THE CHAIRMAN: Before we get onto that, shall we give the shorthand writers a break. Five minutes.

MR. HOLMES: Yes, of course.

(3.03 pm)

(A short break)

(3.12 pm)

MR. HOLMES: Sir, I was making the submission that assessment of future risk does not relate to a finding of fact; it is an evaluation which involves various elements, and of course that evaluation is subject to control by the Tribunal. We say that that control should be moderated by various factors identified by the Tribunal in the pay TV case.

The second point in relation to the merits appeal is that if an error does appear to have occurred, the Tribunal can assess for itself whether the error is a material one. It is not required, as in a judicial review, to set aside a decision because Ofcom has failed to consider some relevant matter, or has considered it at the wrong stage of analysis. The Tribunal can assess on the merits whether some defect or omission of reasoning is sufficient to lead to an error in the substance of Ofcom's decision, and that is clear from a Court of Appeal case, which is at authorities bundle IV, tab 50.

The facts of the case aren't important. It is sufficient to note that this was an appeal from a judgment of the Tribunal, made on a price control case in a section 192 appeal. The point which I would like to draw from this case is at paragraph 24, and there the Court of Appeal stated that:

> "The appeal is against the decision, not the reasons for the decision. It is not enough to identify some error in reasoning. The appeal can only succeed if the decision cannot stand in the light of that error. If it is to succeed, the appellant must vault two hurdles. First, it must demonstrate that the facts, reason and value judgments on which the ultimate decision is based are wrong, and second, it must show that its proposed alternative price control measure should be adopted.
>
> "If the Commission or Tribunal in a matter unrelated to price control concludes that the original decision can be supported on a basis other than that on which Ofcom relied, the appellant will not have shown that the original decision is wrong and will fail."

So in the context of a merits appeal, the challenge is to the decision and not to the reasons. The Tribunal is concerned with errors of result, not immaterial defects of reasoning.

Having set out the legal framework, let me make brief submissions about the errors of law that have been identified. First, it is said that Ofcom applied the wrong legal test. Now, in our submission that is incorrect. Ofcom assessed whether there was a relevant risk that BT might so impose a price squeeze as to have consequences for end users, and that is the correct test. It did not require Ofcom to find a likelihood of a price squeeze arising. If that had been the intended test, other language would have been chosen. We accept that there must be a real risk, and it must be more than a fanciful risk, but it does not require a finding that the dominant operator is more likely than not to engage in a price squeeze, if that is what is meant by "realistic likelihood".

The second allegation of legal error is that Ofcom failed to find a likelihood of anti-competitive effect, and this is made by reference to the decisions under ex post competition law, and we say again that this is incorrect: the statutory test is clear. Ofcom must find that there is a risk of conduct that would give rise to adverse effects to end users if it eventuated, and this is the test that Ofcom applied. The risk relates to whether there is a class of conduct in which the dominant operator might engage which would or could be expected to have adverse effects for end users.

MR. ALLAN: So, just to be clear, you accept that the "would" element in the test does imply a higher level of probability than a risk?

MR. HOLMES: Yes, sir, but in our view it is moderated by the requirement that the conduct must be shown only at the level of relevant risk. So there must be a relevant risk of some conduct, and if that particular type of conduct occurred, there would be end users.

MR. ALLAN: So you might say that there are two levels of probability assessment: one is at the first level, will the SMP operator or BT engage in the conduct at all, and that's a risk assessment; then there is a second level of probability assessment as to the nature of that conduct, and that conduct must be such as would be likely to have the anti-competitive effect; is that how you are putting it?

MR. HOLMES: The type of conduct which must be identified as a risk, a real risk, we accept, is conduct which would have adverse effects on end users. There may be various types of conduct that constituted a price squeeze which would not have adverse effects on end users, but provided that there is a relevant risk of some conduct on the part of the dominant operator which would have adverse effects on end users, that is sufficient to meet the test. So the assessment of the effects on end users concerns the type of conduct which must be identified. The conduct which must be identified must have adverse effects on end users, but there is only a requirement of a relevant risk of such conduct arising. Does that answer

your question?
MR. ALLAN: I think it does.
MR. HOLMES: Thank you, sir.
MR. ALLAN: I think you are agreeing with me.
MR. HOLMES: Yes, sir.
THE CHAIRMAN: Well, I am not sure that you are. I'm not sure I fully understand. There's only one probability test, I think you are saying, that has to be carried out, and that's in relation to the existence of the risk?
MR. HOLMES: Yes. So Ofcom has to be able to identify a real risk that a dominant operator, in this case, BT, might engage in conduct, the effects of which would be to cause adverse effects for end users. So the degree of risk qualifies the conduct and the type of conduct that must be identified is conduct having particular consequences.
THE CHAIRMAN: Yes. That's clear to me.
MR. HOLMES: Thank you, sir.
The third allegation of legal error is that Ofcom wrongly failed to consider the constraints imposed by ex post competition law and existing regulation when it assessed relevant risk.
Now, one answer to this is that Ofcom did consider ex post competition law and FRAND. It did so when deciding whether the VULA margin condition was needed rather than assessing relevant risk. But we say that it is sterile to say that Ofcom considered these matters at the wrong stage of analysis. There is no practical difference between the question whether other regulation removes the relevant risk, and the question whether other regulation removes the need to regulate in order to address the relevant risk. They come to the same thing. It really does not affect the analysis whether that assessment occurs in section 3 of the statement or in section 4.
We say that it is also clear from the legal framework and the guidance that Ofcom was entitled to conclude that ex post competition law and existing regulation were not sufficient.
The materials that I have shown to the Tribunal emphasise the need for sufficient detail relating to the test to be applied, to be set out in advance so that the relevant conduct can be avoided. Neither ex post competition law, nor a FRAND obligation, provides such certainty so as to eliminate the need for a more detailed regulatory intervention.
Both would also be slower to apply and therefore would be less effective in removing the risk of a price squeeze.
A second answer to this submission is that BT accepts that there should be a FRAND obligation in place to address the risk of a margin squeeze, and that must be on the

assumption that the relevant test in section 88(1)(a) and (3) is met, notwithstanding competition law and the BT undertakings, so therefore only the FRAND obligation is relevant in assessing whether to continue with existing regulation, or move to the enhanced price control, to use the language that Mr. Thompson adopted.

The third answer concerns equivalence of inputs and functional separation, and we say that these do not affect the assessment and Ofcom was right not to take them into account. Equivalence of inputs is a non discrimination remedy and margin squeeze does not avoid discrimination, or need not involve discrimination, as the ERG paper made clear. Functional separation is about preventing discrimination and achieving equivalence of inputs. It is not directed at the problem of margin squeeze. It is not a substitute for ex ante obligations as is clear from Article 13A, paragraph 5 of the Access Directive, and moreover, depending on the functional separation model, the dominant operator may retain sufficient strategic control to allow margin squeeze to take place, notwithstanding the functional separation.

These regulatory constraints, therefore, cannot in our submission falsify Ofcom's conclusions about the relevant risk of a price squeeze, and to adopt Mr. Thompson's analogy, a local authority could not be faulted for not considering a factor that is incapable of affecting the speed of traffic when deciding whether to implement a new traffic-calming measure. Neither equivalence of inputs nor functional separation go to the issue that margin squeeze is intended to address.

It was, therefore, not a relevant consideration, and even if it was a relevant consideration, the Tribunal is entitled to uphold Ofcom's conclusion on the basis that it should not have affected the analysis had it been taken into account, and we saw that from the Everything Everywhere authority which I showed to the Tribunal.

So in our submission, this allegation of error in relation to the consideration of alternative regulation and of ex post competition law takes BT nowhere.

The final legal error is the suggestion Ofcom wrongly excluded pay television from consideration. This appears to us to be in reality a complaint about the substance of Ofcom's analysis, rather than a legal matter, and I propose to address it in that context.

Let me now turn to Ofcom's decision, the second part of my submissions in opening, to show the basis on which Ofcom decided to set the VULA margin condition in this case, and this is in hearing bundle volume III, part I at tab 1.

Paragraph 1.1 in the executive summary explains what the VULA margin is, namely the differential between the price of the wholesale VULA input offered by BT, BT's access

division Openreach, and the price of these retail packages offered by BT's retail divisions that use VULA as an input.

Paragraph 1.4 refers to the 2014 Fixed Access Market Review statement, and this was the document in which Ofcom defined the relevant market and planned SMP. It also imposed a range of regulatory remedies including equivalence of inputs, but not a cost plus price control. Instead, as paragraph 1.4 notes, Ofcom decided to preserve BT's broad flexibility over the level of VULA prices, and that approach is preserved in the VULA margin decision.

But Ofcom in the 2014 FAMR statement reserved the question of whether to regulate the VULA margin pending a further consultation, and it then decided in the present document to impose the VULA margin condition.

Section 3 then applies the statutory test from section 88 of the 2003 Act, which is set out in 3.4. So Ofcom directs itself there to the test, whether there is a relevant risk of adverse effects arising from price distortion, and in this case, that requires Ofcom to assess whether BT might so impose a price squeeze as to have adverse consequences for end users of public electronic communications services.

The definition of margin squeeze, or price squeeze, that is found in the Access Directive recital 20 is then set out:

> "A price squeeze occurs when the difference between the dominant provider's retail price is the interconnection prices charged to competitors who provide similar retail services is not adequate to ensure sustainable competition."

The precise difference which Ofcom was concerned with is apparent from the remedy which it imposed. It might assist to briefly look at that now. If one turns to 3.100, Ofcom identifies three potential options for regulating. The first is the classic equally efficient operator test under which a margin squeeze test would be imposed:

> "... to ensure that Ofcom does not set the VULA margin such that it prevents an operator with the same costs as BT being able to profitably match BT's retail superfast broadband offers."

At option 2:

> "Ensures that BT does not set the VULA margin such that it prevents an operator that has slightly higher costs than BT, or some other slight commercial drawback relative to BT being able to profitably match BT's retail superfast broadband offers."

3.104 notes that:

"In practice the difference between options 1 and 2 is likely to be small."

At 3.106:

"Ofcom notes that to consider option 1 to be effective and to rule out the need for even considering the need for any adjustments at this stage, we would want to be reasonably confident that BT did not have any material advantages that cannot be matched by other CPs [communications providers] in a reasonable time frame."

And Ofcom concludes that that is not the case. You will see at the end of 3.107:

"We have identified some slight disadvantages for rival operators relative to BT which we consider would fall within this category."

Ofcom decides on that basis to adopt option 2. So the test then is largely set by reference to BT's own retail costs, but subject to a small adjustment for features of BT's position which other communications providers could not match. Whether Ofcom was right to make that adjustment is, of course, a matter that is for the CMA as part of the design appeal.

Turning back, then, to the assessment of relevant risk, Ofcom first explains the relevant market context for its assessment, beginning at 3.53 on page 29. It notes at paragraph 3.54 that:

"Regulation at the wholesale level has achieved competition to the benefit of consumers in relation to standard broadband."

However, in paragraph 3.55, it notes that:

"The structure of the superfast broadband segment could be very different, based on observable trends."

The first bullet notes that:

"BT has been winning a substantial share of VULA-based retail superfast broadband subscribers, well over half of VULA additions."

The forecasts from BT show that it expects, at the second bullet, to continue winning a large share of additions and that the subscribers that it wins are unlikely to be purely upgrades but, rather, customers won from competitors, for reasons that are then set out in a confidential portion.

There is then a discussion of communication providers' forecasts in the final bullet, and how they expect the sector to develop. The figures are confidential, but they are set out in graphical form in the witness statement of Mr. Matthew for Ofcom, which is at hearing bundle volume II at tab 12. If I could ask the Tribunal to keep the decision document open, because we will return to that, but to pick up for a moment Mr. Matthew's statement at

tab 12 of hearing bundle II and to turn to page 20. This shows the top five communication providers' actual shares for broadband services with headline speeds of 30 megabits per second and above. So that is superfast broadband. So we are confined here to the superfast segment.

The green line is Virgin Media's share. Now, Virgin Media does not use the VULA input; it has its own cable network, but it is a closed network, so it is the only communications provider that can make use of that network.

Sir, do you have the relevant page? **(Pause)**.

It is tab 12 of bundle II at page 20.

THE CHAIRMAN: I have it.

MR. HOLMES: The green line shows Virgin Media's share. The line, it's either brown or purple, depending on how your printing has come out, shows BT's shares.

Then you also see some other providers, EE, TalkTalk and Virgin are the three communications providers that are the main competitors of BT across all broadband offers, and this graph puts in context the figure that you were shown this morning, showing the acceleration from Mr. Tickel's evidence, showing the increase in VULA lines rented by other communications providers.

You will see there the other communications providers are shown in the blue, orange and red lines, and BT's share is shown in the brown line.

The overall trend is explained on the preceding page at paragraph 35, which is that these forecasts suggest that by the end of the review period, both BT and the other main -- the provision of superfast broadband would be closer to a duopoly between BT and Virgin Media.

This is in contrast with the present position where there are four strong competitors for broadband generally at retail level. One sees that at page 16 where the retail shares of all broadband services are set out in figure 2. You see the final row shows all connections with a division amongst the four main providers. Then the others, who are described as a "competitive fringe".

The other point to note is that superfast broadband is growing in importance, and it would be fair to say that it represents the future of retail broadband provision. You see the figure 3 over the page at page 17 of Mr. Matthew's statement. Mr. Matthew explains why Ofcom regarded this market context as relevant. At paragraph 45 of his statement, on page 23, he notes in the final sentence, beginning halfway through the paragraph:

"If there are other market factors that suggest that BT may be on a path to

obtaining a strong position in superfast broadband in the medium term even if it does not distort competition by imposing a price squeeze, that is all the more reason to be concerned if BT did decide to impose a price squeeze because it would add to an already strong position held by BT."

The market context is also relevant to an assessment of incentives for the reasons given at paragraphs 53 and 54 of Mr. Matthew's witness statement on page 26. Mr. Matthew notes there that:

"BT's incentives to use the VULA price in order to support its retail business are likely to be particularly strong in the current market review period ... growing importance of superfast broadband, which is likely to emerge as a product marketed in its own right or to become a predominant form of broadband sales within a broader market... current review period is likely to be a key period of transition. The choice to upgrade may lead customers to consider moving. The general retail broadband strategy of BT is to differentiate itself by reference to fibre."

And at 53(e):

"The evidence indicates that BT's success in driving superfast broadband sales to date includes the class of customer ..."

Which are described in the blue text at point (e). At (f) there is also the point that:

"To the extent that raising the VULA price results in BT gaining consumers from its competitors not only for broadband products, that could increase the benefit to BT for raising the VULA price."

And the conclusion:

"The market context adds to the real and significant risk that BT has an incentive to use the VULA price to distort competition by imposing a price squeeze."

So returning now to the decision, if we may. Picking up paragraph 3.58, against the market context which we have considered, Ofcom assesses the risk of adverse effects by reference to four factors: BT's ability to impose a price squeeze, BT's incentives, whether there are other factors in the market that would remove the risk of a price squeeze, and if realised, the impact of the price squeeze on end users of public electronic communications networks. The discussion of ability begins at paragraph 3.60, but Ofcom points that BT is able to price squeeze, having regard to four matters: first, as explained in paragraph 3.61, BT controls the essential wholesale inputs needed to provide retail broadband. The only operator who can

avoid that control is Virgin, because of its own network, but Virgin does not supply other communication providers with wholesale inputs in competition with BT.

Secondly, and in consequence, BT has been found to have SMP in the relevant market, Virgin does not impose a sufficient constraint because its closed network covers only approximately half of premises. That's the point made towards the end of paragraph 3.61.

The third point, which emerges from the second sentence of 3.62, is that BT is vertically integrated and can directly link the ability directly to affect the ability of other CPs -- communications providers -- to compete in the downstream provision of superfast broadband, so it has both upstream and downstream operations.

The fourth point, at the end of paragraph 3.62, is that:

> "BT has more freedom to impose a price squeeze because of Ofcom's decision not to set a costs base charge control for the wholesale price of VULA in this review period, meaning BT has control over both the relevant wholesale price and its retail superfast broadband prices."

You will recall from the recommendation that this circumstance was one that was specifically identified in the recommendation as one of relevance in deciding the appropriateness of imposing a margin squeeze remedy.

The point is that BT can profitably price squeeze because the wholesale price can be raised allowing it to take its profits upstream. Unlike predatory pricing where a dominant firm is losing money in the short-run, BT may be able profitably to engage in an indefinite price squeeze, and we don't understand the finding of an ability to price squeeze to be seriously in contention. BT's economic expert, Mr. Bishop, proceeds on the basis that a firm would possess the ability to engage in a margin squeeze if it possesses significant market power upstream.

The reference, for your note, is paragraph 33 of his first report, at hearing bundle II, tab 9, page 10 and, of course, the finding of significant market power in this case isn't in contention.

Ofcom then turns to consider the incentives of BT to impose a price squeeze, beginning at paragraph 3.64. At the beginning of paragraph 3.64, it makes the important preliminary point that given the forward-looking nature of a market review there is inherent uncertainty in assessing the incentives to engage in a particular behaviour. One important aspect of uncertainty is the development of demand for superfast broadband over the period of market review. If consumer preference continues to shift strongly to superfast broadband, for example, this will weaken the constraints from standard broadband, increasing the

incentives to price squeeze.

I should return, at this point, to a passage that you were shown this morning from the WBA market review, which concerned the market definition at the retail level for broadband, and you will recall that this was a document in which Ofcom found a single downstream retail market embracing both standard broadband and superfast broadband for the period of the market review, the first of the relevant facts to which Mr. Thompson adverted in opening.

That document is in hearing bundle III, part 2, at tab 7. There are two parts that I would draw your attention to. The first is the discussion of future developments at paragraphs 3.67 to 3.70:

> "Ofcom recognises that consumer requirements for broadband speeds may increase in the future and that this could potentially result in a lessening of the substitutability of SFBB (superfast broadband) and SBB (standard broadband) services for consumers. For example, overall increases in the penetration of internet-enabled TVs, tablets and computers is likely to continue, and this could increase simultaneous viewing of catch-up TV, meaning faster broadband would be required by more households in order to satisfy their increased needs.
>
> "Ofcom recognises that more consumers may regard SFBB services as necessary in future, and there may be an endowment effect that means that consumers are reluctant to trade down once they have experienced SFBB."

So once you have moved across, it may be unlikely that you will go back to SBB.

> "However, the speed and extent of the transition to SFBB over the period of this review is subject to significant uncertainty at this point."

And at 3.71, the conclusion. Ofcom's overall assessment is very nuanced. On balance the evidence suggests that it is appropriate to define a single market for broadband services at all speeds. We acknowledge that there are factors pointing to a separate market potentially emerging at retail level at some point in the future, however there is insufficient evidence to conclude that this is likely to occur during the three-year forward look period of this market review. So considerable uncertainty then about the extent of the constraint that standard broadband will supply in relation to superfast broadband at the retail level over the course of this market review period, and this is one of the uncertainties that affects Ofcom's assessment, as set out in the contested decision.

So if I could ask you, now, to pick up the contested decision again and return to

paragraph 3.64.

> "Notwithstanding the uncertainty that is a necessary feature of this assessment, Ofcom finds that there is a significant and real risk that BT has an incentive to impose a price squeeze."

One sees that in the second sentence of 3.64. There are essentially six points that are made by Ofcom in support of that conclusion. First, at paragraph 3.65, Ofcom observes that:

> "If BT sets a VULA margin so as to impose a price squeeze, it undermines the ability of other communications providers to compete and therefore is likely to retain those subscribers that are interested in superfast broadband and to win them from its rivals."

The point is that if BT squeezes the margin between its wholesale and retail prices sufficiently, even to the extent that it cannot cover its own retail costs, or a nearly efficient operator couldn't do so, there is a clear risk that competition will be softened, and Mr. Matthew expands on this point at paragraph 49 of his witness statement. If I could just return now for a moment, it's at hearing bundle II/12/24. He notes that:

> "The terms of supply of VULA to BT's retail competitors will influence the nature and intensity of competition that BT's retail operations face. If BT sets a higher VULA price [that is, a higher VULA price relative to its retail offers, as is clear from the clarification at paragraph 52 further down] that will raise the cost to competitors in supplying superfast broadband products. BT's retail competitors might respond to this cost increase in various ways, but prominent among them are likely to be:
>
> "(a) Passing on the cost increase to higher retail superfast broadband prices ..."

And that obviously makes the competitors' retail offers less attractive to consumers relative to BT's offers.

> "(b) Reduced margins for BT's competitors in supplying superfast broadband products."

And that would reduce competitors' incentives to invest in customer acquisition, again likely resulting in higher volumes for BT Consumer.

And, thirdly:

> "(c) Overall profitability in superfast broadband supply [at the retail level] would deteriorate."

It is possible that in consequence competition from rivals might result even in complete exit from superfast broadband.

The second point made, and now if I could just go back to the statement -- I'm sorry to jump around like this. Some of the material in the statement itself is quite concentrated and it is, therefore, helpful just to see it in its context.

Returning to 3.64, so the first point then is that a VULA margin, a price squeeze undermines the ability of other communications providers to compete, reducing their ability to win superfast broadband subscribers.

The second point is that competing operators require a degree of regulatory and market certainty to facilitate their ongoing investment, and one sees this, as I say, at paragraph 3.65, at the top of page 34.

Footnote 123 develops the point that an operator incurs upfront acquisition costs to win over a customer and recoup that investment over the period that the customer remains with the operator, and if BT's rivals found that their margins were squeezed, they would be more reluctant to incur the upfront costs and BT may be able to build a large share.

THE CHAIRMAN: Sorry, where are you reading from now?

MR. HOLMES: I am so sorry, it is footnote 123.

MR. ALLAN: Of the statement?

MR. HOLMES: Yes, I am now back in the statement.

MR. ALLAN: At 3.123.

MR. HOLMES: Exactly. 3.65, footnote 123.

MR. ALLAN: Oh, footnote.

MR. HOLMES: Apologies, on page 34. Page 34 of tab 1, hearing bundle III, part I.

I am sorry, sir, I perhaps made that transition too rapidly.

THE CHAIRMAN: Okay, carry on.

MR. HOLMES: The second point that Ofcom notes is that:

> "A degree of regulatory and market certainty is needed to facilitate ongoing investment."

A point, of course, that is familiar from the recommendation that we saw earlier, and the concern is that, as explained at footnote 123:

> "An operator incurs upfront costs acquiring a superfast broadband customer, marketing, connection costs, provision of a router."

These are all expenses that must be borne at the outset, and those are then recovered over the course of what's described as the customer's "lifetime", by which is meant the period of time for which the customer remains with the operator in question through the ongoing monthly margin that is earnt on that customer.

If BT's rivals found that their margins were squeezed, they would be more reluctant to incur those upfront costs and BT may be able to build a large share of retail superfast broadband subscribers in the longer run, the point that is then made in the final sentence of 3.65.

BT itself, of course, would not share the same reluctance: supply could remain profitable for it at the upstream level, it could take its profits at the wholesale level.

The third point made by Ofcom appears at the start of 3.66:

> "If BT builds up a sufficiently large retail base by engaging in such activity, it might be able to obtain advantages over its rivals [this is the first sentence of 3.66], for example in respect of marketing and economies of scale."

So the point here is that it would have more subscribers to spread certain costs across, and its competitors would have a smaller subscriber base over which to recover the equivalent costs that they incurred. And, as footnote 124 records:

> "Such an effect may not have arisen to date in the standard broadband segment, where there are four well established operators, each with a respectable share of subscribers, but it could arise in relation to superfast as the market moves to superfast broadband."

Fourth, as explained in the fourth line of paragraph 3.66:

> "This effect may be compounded if there are also significant customer switching costs, for example due to minimum contract lengths or subscriber inertia, as it will increase the costs faced by rivals to win customers back from BT in order to establish themselves as effective competitors in superfast broadband."

So the concern is that, for example, retail minimum contract lengths could lock customers in for a fixed period, and that also there would be the problem of subscriber inertia; the fact that when a customer has a product, a superfast product, they may be unlikely to move subsequently.

For your note, Mr. Matthew expands on the subscriber inertia point, at paragraph 103 of his statement -- I don't propose we go there now, but he refers to research showing that only a small proportion of broadband customers over the last year considered switching provider -- well, in 2014, I should say -- and the perceived hassle factor of doing so was the most important disincentive to switching.

MR. ALLAN: Sorry, where is that in Matthew?

MR. HOLMES: I am so sorry, it is at paragraph 103 of his statement, which is hearing bundle II/12/47.

So once BT has secured a scale advantage through a price squeeze, the fourth point is that it

may be difficult for retail competitors to undo.

As Ofcom noted at paragraph 3.67:

> "A price squeeze could produce effects on the market enduring into the longer term, weakening BT's competitive constraints."

The fifth point that Ofcom took into account in assessing BT's incentives was the fact that the market is at an important transition or inflection point, and one sees this at paragraph 3.68:

> "We consider that the risk of this incentive is particularly significant in this review period, given the following context: the transition from standard broadband and the future role of superfast broadband and VULA."

And the related point:

> "The period covered by this market review is likely to be an important stage in this migration of superfast broadband and competitive conditions in the future are likely to be affected by developments in this period."

Paragraph 3.70 records that:

> "The period is likely to see a further increase in take-up of superfast broadband, and that superfast broadband services are likely to be highly important in the future, beyond the present market review period."

3.71 notes that:

> "The growth in superfast broadband is consistent with the forecasts provided to Ofcom by communications providers."

And at 3.72, Ofcom finds in consequence that:

> "The period of the present market review is likely to be an important stage in the migration to superfast broadband and competitive conditions in the future are likely to be affected by developments in this period."

At paragraph 3.73, Ofcom notes that:

> "This represents a disruption to the market, giving retailers, including BT itself, the opportunity to win customers over from competitors through the offer of superfast broadband."

For the Tribunal's note, the second bullet of paragraph 3.55 records confidential data -- a little earlier -- in support of Ofcom's conclusion that BT's VULA growing number of subscribers are unlikely to be purely upgrades of BT's existing standard broadband subscribers.

Now, the importance of this period to future competitive conditions is, in our submission,

borne out by certain strategy documents provided by BT during the market review, and these are set out in annex A1 to the final statement, but they can also conveniently be found, and more legibly be found, at least in my version, in the annex to Mr. Matthew's statement, so if I could ask you to switch back again, hearing bundle volume II, tab 13, and turning to page 63, the numbering continues from the previous statement. If I could just ask the Tribunal to review -- you see the heading at the top of page 63:

> "[Superfast broadband] a key element of BT's strategy in broadband."

These are confidential so I shall ask you to read to yourself, if you may, the excerpt in 7, 8, 9 and 12 -- 9 is a summary rather than a quotation. **(Pause)**.

For the avoidance of doubt, we don't suggest that there is anything illegitimate or inappropriate in any of these strategic comments; they are simply to confirm the proposition that this is an important transition point in the market, which was a consideration that Ofcom relied upon in its analysis of incentives.

If I could turn back to the decision, so back to hearing bundle III, volume I, we were at page 35 and over the page to 36. So 3.74, the conclusion:

> "This market review period potentially represents a period where BT can win significant subscribers from its competitors and upgrade its existing subscribers, possibly locking them in for a minimum term."

Then at paragraph 3.75, you get the reiteration of the finding of a real and significant risk. BT has an incentive to impose a price squeeze based on the five considerations that I have identified.

Ofcom then turned to consider whether there were factors which negated the risk, despite the considerations set out in the preceding paragraphs. To be clear, this doesn't represent any placing of the onus on BT. Ofcom was properly considering relevant matters in arriving at an overall assessment, and these are other considerations that were relevant to its assessment.

Paragraph 3.78, you see existing legal and regulatory constraints, in particular the FRAND obligation, and no undue consideration, equivalence of inputs and ex post competition law were referred to, and these were said by BT to remove the risk of a price squeeze. Ofcom there explains its view that these should be addressed when considering whether a VULA margin remedy was needed, having regard to the so-called modified greenfield approach. But as Ofcom also explains at paragraph 3.78, it did consider ex post competition law and FRAND in section 4 and found that they did not remove the need for the VULA margin regulation, and as I submitted previously, the conclusion that a VULA margin regulation is

necessary, because these other constraints arising from ex post competition law and FRAND aren't sufficient to deal with the problem, comes to the same thing as assessing whether there is a relevant risk of a -- whether they remove a relevant risk of a margin squeeze. We say that there is no significance to be attached to the placing of the analysis where those points are considered.

Even taking BT's case as a sort of formal objection, we say that section 3.78 specifically incorporates by reference the analysis of ex post competition law and the existing regulation, which is contained in section 4.

At paragraph 3.79, Ofcom turns to consider prospects for increased competition going forward. Here Ofcom addressed BT's argument that Sky and TalkTalk were just gearing up, and the costs of VULA installation were falling, and the short answer to this is given in the first bullet following the bold text:

> "Ultimately the ability and, indeed, the incentive for other communications providers to compete effectively in the retail provision of superfast broadband is directly affected by the VULA margin which, as set out above, BT directly controls. In other words the prospects for competition are themselves affected by the measure under consideration."

And as noted at paragraph 3.80 BT's position in superfast broadband is expected to remain strong throughout the market review period based on its own forecast.

Paragraph 3.81 notes the direction of change in BT's more recent forecasts in a confidential passage.

Ofcom then turns at 3.82 to consider three further considerations which BT identified in the consultation process. The first point was that in the event of a competitor being excluded from superfast broadband, it was said that BT could not be sure of winning the competitor's customers, given product differentiation between them. Customers might choose not to purchase superfast broadband at all and to remain instead on a standard broadband package with their existing provider.

Now, Ofcom didn't consider that this removed the relevant risk. It notes in the middle of the paragraph that in its view it is highly unlikely that at least some consumers in such a scenario would switch to BT.

It notes the proportion of new superfast broadband subscribers in the third quarter of 2014 who were new to BT, showing that that proportion of consumers, or some consumers, consider BT to be an alternative to their existing provider. The relevant proportion is confidential, but is set out in the blue text in the first bullet.

Because of the way BT had put this point, Ofcom here considers only the possibility of complete exclusion, but in paragraphs 3.96 to 3.97, Ofcom considers the possibility of operators using some competitive advantage over BT to absorb the cost imposed by the margin squeeze as an alternative possibility.

So at 3.96, Ofcom first considers the VULA margin in relation to BT's own costs and considers what the impact would be on an operator identical to BT if BT set a VULA margin such that an operator with the same costs is unable to profitably match its retail superfast broadband operators. It finds that in that case that if BT did not allow sufficient margin to operate profitably itself in retail level, this would clearly place such an operator at a competitive disadvantage.

At paragraph 3.97, Ofcom considers the situation of operators not identical to BT, and it notes that they may have legitimate advantages which would enable them to win customers, notwithstanding such a squeeze, but Ofcom notes that there is still a risk of exclusion. On the one hand, BT -- you will see the sentence beginning "However", in the sixth line:

> "BT might be able to set the VULA price at a higher level to compensate for or to outweigh its competitive disadvantage. It would distort competition and be liable to adversely affect rivals' incentives to compete for superfast broadband customers."

So BT would be removing the competitive advantage, or at least dampening the competitive advantage by increasing the costs of its rivals by comparison with its own downstream retail operations.

The second point:

> "Such an insufficient VULA margin would diminish the ability of other operators to profitably compete against BT for particular customer segments."

So for those customers in relation to which a customer did not enjoy an advantage, given their preferences, those, for example, that placed a high value on superfast broadband and weren't particularly interested in other bundled elements, BT could gain an advantage, notwithstanding the competitive advantages in relation to some other field of activity, such as pay television or sports rights.

Returning to -- if I could just flick back, I took us out of turn, because those points related to the first bullet, or developed the issue considered at the first bullet at 3.82.

The second bullet at 3.82 addresses the consideration that Openreach has an incentive to maximise utilisation of its network and so does not have an incentive to exclude rivals.

Now, the answer that Ofcom gives, it's at the top of page 40, BT of course has a balancing

act to consider here; it trades off higher volumes against lower prices, and while a higher wholesale VULA price may reduce the volumes supplied to competing retailers, BT may itself increase its own retail volumes, generating increased profits for itself at the retail level, and, equally, it will still enjoy wholesale returns based on a higher wholesale price at the wholesale level.

Then the third bullet at 3.82 considers the constraints imposed by standard broadband and by Virgin Media. Superfast broadband not based on VULA is Virgin Media. Standard broadband is the product provided using LLU by BT's retail competitors.

In this connection Ofcom recognises that there is some constraint arising from those sources, however, Ofcom did not consider that these retail constraints would be sufficient to undermine BT's incentive or ability to price squeeze. It noted the finding of significant market power, and it did not consider that either will prevent BT from gaining some longer term advantages from a strong retail position in superfast broadband resulting from imposing a price squeeze during this transition period.

So those were the considerations that Ofcom took into account in assessing whether there was a relevant risk.

It then turned to consider whether the conduct in question might give rise to adverse consequences. So it considered at 3.82 whether such behaviour would have adverse consequences for end users of public electronic communication services, and it found that this was not the case. I shall just, given the time, very briefly identify the relevant considerations.

Firstly, at 3.85 it noted that standard and superfast broadband are not perfect substitutes: they are clearly differentiated in quality terms, and that retail competition for the superfast broadband segment matters, even though it is currently part of the wider broadband market.

Secondly, there is a concern of weakening constraints over the period of the market review, as more consumers consider superfast broadband and more differentiated service from standard broadband.

Thirdly, there is the point that competition is not only about price and that there are constraints arising in relation to innovation, marketing efficiency and other matters.

Fifthly, there is a concern that adverse effects might arise after the market review period when the constraint from standard broadband diminishes as superfast broadband emerges as a more differentiated product.

Then the sixth point was to consider whether it was appropriate to wait, as BT contended, to see whether problems arose in the next review period, and Ofcom conclude that that would

not be appropriate because by then the effectiveness of competition would already have been dampened and more intensive regulation might be needed to correct it. It was more appropriate to act now in order to avoid the problem arising in the future.

Then the seventh point, Ofcom was also concerned about incentives for the future on the part of competitors. At 3.91, Ofcom notes that if BT were to engage in a price squeeze, that could signal that it is willing to punish rivals that compete too aggressively in the longer term by imposing such a squeeze, weakening competitive pressures in the future and this would discourage investment going forward.

So on that basis Ofcom concluded that there was an ability to impose a price squeeze; that there was a real and significant risk that BT had incentives to impose a price squeeze, and that also if BT did impose such a price squeeze, this could be expected to have adverse consequences for end users.

In our submission, taking these factors together, it is incorrect to suggest that the exercise undertaken by Ofcom was a purely theoretical exercise; that Ofcom did not consider whether there was a real risk, it did not consider the real world, it did not consider whether there was a risk of a real margin squeeze.

Ofcom considered those things by reference to real world conditions, based not only on market shares, but on a variety of factors and considerations affecting the market. It identified concrete factors informing Ofcom's assessment of risk relating to the structure of competition in this market, the factors that would affect the strength of retail competition going forward, and the plausibility of BT gaining an enduring advantage over the longer term.

Ofcom took specific account of the presence of Virgin Media and the constraints of standard broadband, but concluded that they were not sufficient to allay its concerns.

Ofcom also took account of the possibility of competitive advantages enjoyed by competitors, but considered that BT might still attempt to weaken competitive constraints by undermining or reducing those competitive advantages by increasing the costs of its rivals through a margin squeeze mechanism.

Ofcom did not undertake a more quantified exercise, and you will hear evidence about the reasons for that, but the short point is that this market is a very dynamic one, and we have seen that there is considerable uncertainty about a number of factors, conditioning, demand conditions in the market, and that would make it very difficult, in our submission, to undertake such a quantified exercise. That is the evidence of Mr. Matthew, and it may well be the subject that will be explored in the course of cross-examination, and it is not

necessary to perform such a quantified exercise in order to reach a conclusion as to whether there is a relevant risk.

Sir, those are Ofcom's opening submissions, and tomorrow we will explore the issues further in the evidence.

THE CHAIRMAN: Thank you very much. 10.30 am tomorrow.

(4.22 pm)

(The hearing adjourned until 10.30 am on Thursday, 10 December 2015)

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