Neutral citation [2016] CAT 3

IN THE COMPETITION APPEAL TRIBUNAL

Case No.: 1238/3/3/15

Victoria House
Bloomsbury Place
London WC1A 2EB

24 March 2016

Before:

ANDREW LENON QC
(Chairman)
WILLIAM ALLAN
PROFESSOR COLIN MAYER

Sitting as a Tribunal in England and Wales

B E T W E E N:

BRITISH TELECOMMUNICATIONS PLC

Appellant

- v -

OFFICE OF COMMUNICATIONS

Respondent

- and -

SKY UK LIMITED
TALKTALK TELECOM GROUP PLC

Interveners

Heard at Victoria House on 9-16 December 2015

JUDGMENT ON NON-SPECIFIED PRICE CONTROL MATTERS

APPEARANCES

Mr Rhodri Thompson QC, Mr Nicholas Gibson and Ms Anita Davies (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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1. INTRODUCTION

1. This appeal by British Telecommunications PLC ("BT") is against the decision of the Office of Communications ("Ofcom") contained in its Statement entitled "*Fixed Access Market Reviews: Approach to the VULA margin*" dated 19 March 2015 (the "Statement"). VULA stands for "Virtual Unbundled Local Access"; it is the wholesale product through which communications providers ("CPs") have access to BT's next (or second) generation network, which supports the provision of superfast broadband ("SFBB") services to consumers. In the Statement, Ofcom says that it is concerned that BT could distort the development of competition in SFBB by setting an insufficient margin between the price of VULA and the price of its retail packages which use VULA as an input. The Statement imposes obligations on BT that regulate the VULA margin and are intended to ensure that other CPs have sufficient margin to be able to compete with BT in the provision of SFBB packages to consumers.

2. The appeal is brought under section 192 of the Communications Act 2003 (the "2003 Act") and is subject to the procedure set out in section 193 of that Act. That procedure requires the Tribunal to identify whether an appeal raises any "specified price control matters". The price control matters to which the procedure applies have been specified in Rule 116 of the Competition Appeal Tribunal Rules 2015 (SI 2015 No. 1648). If an appeal does raise specified price control matters, then those matters must be referred by the Tribunal to the Competition and Markets Authority ("CMA") for determination. Matters raised by the appeal which are not specified price control matters are to be decided by the Tribunal. Once the CMA has notified the Tribunal of its determination of a price control matter referred to it, the Tribunal must decide an appeal in relation to that matter in accordance with the determination of the CMA, unless the Tribunal decides, applying the principles applicable on an application for judicial review, that the CMA's determination would fall to be set aside on such an application.

3. The Statement is the subject of two appeals: one by BT (Case 1238/3/3/15) and the other by TalkTalk Telecom Group PLC ("TalkTalk") (Case 1237/3/3/15). Following a case management conference on 18 June 2015, the Tribunal decided to permit interventions by Sky UK Limited ("Sky") and TalkTalk in Case 1238[1] and intervention by BT in Case 1237.

4. Both appeals raise specified price control matters; these were referred to the CMA on 5 January 2016 with directions to determine the references within six months.

5. BT's appeal also raises non-specified price control matters. The categorisation of the various grounds in BT's Notice of Appeal as either specified or non-specified price control matters was considered at the case management conference on 18 June 2015. There was no disagreement that Ground 1 was a non-specified price control matter that would fall to be determined by the Tribunal. However, the Tribunal decided that Ground 5A should also be categorised as such. Under this ground, BT contends that Ofcom was wrong to consider that any additional regulation was required beyond that already in existence. In its Ruling following the case management conference, the Tribunal held as follows:

> "41. The debate over the classification of Ground 5A highlights the potential overlap between specified and non-specified PCMs [price control matters] and the need to analyse closely both the nature and context of an appellant's case in order to determine on which side of the line a ground of appeal falls. BT submits that Ground 5A (like Ground 6) raises an issue of proportionality, calling into question whether the regulatory status quo, including the fair and reasonable condition imposed by the Fixed Asset Market Review 2014 (the "FRAND measure"), is a sufficient form of price control. It contends that that question of proportionality is a matter of design and that Ground 5A therefore raises a specified PCM.
>
> 42. We accept that, if there were no existing FRAND measure and BT's complaint was that Ofcom had erred in imposing the Condition rather than the FRAND measure, that would be a design question raising a specified PCM. In that context, the prior question would be as to whether there was

[1] The role of the interveners in BT's appeal (that is, Sky and TalkTalk) was initially limited to written submissions. Subsequently, both parties applied to participate at the hearing. Following confirmation by BT that it did not wish to cross examine any of the witnesses of fact or (in the case of Sky) the economic expert tendered by the interveners, they withdrew those applications.

> a need for any price control at all (a non-specified PCM): but, in view of BT's acceptance of the need for the FRAND measure, that question would not be raised. In the present context, the prior question is (as the CMA submitted) whether, given the existence of the FRAND measure, there is an outstanding problem that needs to be remedied by an enhanced price control. Ground 5A essentially raises that question and is therefore not a specified PCM. ([2015] CAT 13, [41]-[42])

6. Following that Ruling, BT amended its Notice of Appeal so that Ground 1 now also encompasses the arguments previously raised under Ground 5A. Ground 1 of the amended Notice of Appeal alleges that the decision contained in the Statement fails to make out a 'relevant risk of adverse effects arising from price distortion' as required by section 88(1)(a) of the 2003 Act. That is based on a range of arguments that Ofcom's market analysis is deficient and cannot withstand profound and rigorous scrutiny.

7. This is the Tribunal's unanimous judgment on Ground 1, dealing with the non-specified price control matters in BT's appeal.

8. In the remainder of this judgment we first give a broad outline of the regulatory framework; this is followed by a brief overview of the history of broadband regulation in the UK and a summary of the Statement in so far as it is relevant. We then set out our approach to the determination of Ground 1. Finally, we consider the arguments that BT advances under Ground 1, grouping them, for the sake of convenience, in the following way:

   A. Did Ofcom adopt the wrong approach to the assessment of relevant risk of adverse effects arising from a price squeeze? (paragraphs 49-133)

   B. Did Ofcom err in law by failing to take account in its market analysis of legal and regulatory constraints affecting BT? (paragraphs 135-158)

   C. Did Ofcom fail to give sufficient weight to existing legal and regulatory constraints? (paragraphs 159-183)

D. Was Ofcom wrong to consider that additional regulation was required? (paragraphs 184-185)

E. Did Ofcom fail to analyse the prevailing market conditions to the requisite standard? (paragraphs 186-234)

2. COMMUNICATIONS REGULATION FRAMEWORK

9. In this part we give a broad outline of the legal framework that applies to communications regulation, including broadband, in so far as it is relevant to this judgment.

10. Communications regulation has been harmonised at European level by a suite of directives that are referred to collectively as the Common Regulatory Framework (the "CRF"). The relevant directives for the purpose of this judgment are the Framework Directive (2002/21/EC) (the "FD") and the Access Directive (2002/19/EC) (the "AD"). Under the CRF, national regulatory authorities ("NRAs") are required to define relevant markets within their territory, to analyse those markets in order to determine whether they are effectively competitive and to identify operators that have significant market power ("SMP"), in accordance with the procedure specified in Articles 15(3) and 16 of the FD. Pursuant to Article 8(2) of the AD, where an operator is designated as having SMP, NRAs are required to impose one or more of the obligations specified in Articles 9 to 13 of the AD ("SMP conditions") as appropriate. The powers relevant to the present case arise under Article 13 of the AD which provides for the imposition of price control and cost accounting obligations in the circumstances described more fully below.

11. The CRF is implemented in the UK primarily by the 2003 Act. Ofcom is the appointed NRA in the UK. The obligations regarding market analysis and SMP findings referred to in the preceding paragraph are mirrored in sections 78 and 79 of the 2003 Act. Ofcom's duty to set SMP conditions is set out in

section 87. Section 87(9) specifies that Ofcom's power to impose price controls is subject to section 88. Section 88, which is the principal provision with which this judgment is concerned, provides:

> "**88 Conditions about network access pricing etc**.
>
> (1) Ofcom are not to set an SMP condition falling within section 87(9) except where—
>
> (a) it appears to them from the market analysis carried out for the purpose of setting that condition that there is a relevant risk of adverse effects arising from price distortion; and
>
> (b) it also appears to them that the setting of the condition is appropriate for the purposes of—
>
> (i) promoting efficiency;
>
> (ii) promoting sustainable competition; and
>
> (iii) conferring the greatest possible benefits on the end-users of public electronic communications services.
>
> (2) In setting an SMP condition falling within section 87(9) Ofcom must take account of the extent of the investment in the matters to which the condition relates of the person to whom it is to apply.
>
> (3) For the purposes of this section there is a relevant risk of adverse effects arising from price distortion if the dominant provider might—
>
> (a) so fix and maintain some or all of his prices at an excessively high level, or
>
> (b) so impose a price squeeze,
>
> as to have adverse consequences for end-users of public electronic communications services.
>
> (4) In considering the matters mentioned in subsection (1)(b) Ofcom may—
>
> (a) have regard to the prices at which services are available in comparable competitive markets;
>
> (b) determine what they consider to represent efficiency by using such cost accounting methods as they think fit.
>
> (5) In this section "the dominant provider" has the same meaning as in section 87.

12. Section 88(1)(a) and (b) of the 2003 Act require Ofcom to consider two questions:

(i) a "threshold" question as to the existence of a relevant risk of adverse effects arising from price distortion (section 88(1)(a)); and

(ii) a "design" question as to the appropriateness of the proposed condition in view of the statutory criteria (section 88(1)(b)).

13. Section 88(3) states that a price distortion may arise from excessively high prices or from a price squeeze. This case is concerned solely with the latter possibility.

14. For clarity and convenience only, in this judgment a "price squeeze" means a price squeeze for the purposes of the CRF and a "margin squeeze" means a margin squeeze as described in the jurisprudence and decisional practice applying Article 102 of the Treaty on the Functioning of the European Union ("TFEU") and its precursors.[2]

15. We consider at paragraphs 49-133 below the arguments advanced by the parties on the interpretation of this section.

3. BROADBAND REGULATION

The development of broadband products and regulation

16. Ofcom provided a helpful overview of the background and context to broadband regulation by way of the witness statement of Mr Clarkson; this was supplemented by the perspectives offered by BT, Sky and TalkTalk.

17. There are two networks in the UK that support the majority of broadband connections: BT's network, which (taken as a whole) has near ubiquitous coverage, and Virgin Media's end-to-end network, which currently covers about 44% of UK premises. Given the scale of BT's network, both in geographic reach and number of customers that rely on it, Ofcom has found that BT has SMP in wholesale markets related to the supply of broadband. BT has not appealed that finding.

[2] Where appropriate, references to Article 102 TFEU include references to its precursors, Article 86 EEC and Article 82 EU, which are expressed in substantially identical terms.

18. Over the past 15 years, BT has been required to provide wholesale access to its network in various forms. Competitors have used this to build their own retail broadband services, which they offer to consumers in competition with BT and with one another.

19. BT started to make broadband available in 1999, using the asymmetric digital subscriber (or "ADSL") technology in its local exchanges. This network technology is often referred to as 'first generation' broadband and the associated retail services are often referred to as standard broadband (or "SBB"). Since 2005, access to that network has primarily been through a process known as Local Loop Unbundling (or "LLU"). LLU gives other operators access to BT's existing telephone lines (i.e. the copper wires that run between the local exchange and the consumer premises) so that they can deploy their own equipment and make available their own broadband services. Ofcom has regulated the absolute level of LLU charges from its introduction and still does so today.

20. Commencing in 2009, BT made a significant investment in the deployment of fibre broadband. This principally took the form of a fibre bypass from the local exchange to the cabinet adjacent to 100 - 200 residential premises which replaced the copper link in a way that is both quicker and more reliable. This network technology, which is often referred to as 'next generation' access or 'second generation' broadband, supports the provision of SFBB services at the retail level.

21. The first time that BT's next generation broadband products were regulated under the 2003 Act was in Ofcom's Statement entitled *Review of the wholesale local access market, Statement on market definition, market power determinations and remedies* in 2010 (the "2010 Statement"). Ofcom required BT to provide wholesale access to its new fibre broadband network, in the form of VULA, on fair and reasonable terms, conditions and charges (Condition FAA 11.2) and on an Equivalence of Inputs basis (Condition FAA 11.3); the latter means that BT must not provide VULA access for its own services unless it provides such access to third parties on the same basis.

Ofcom did not regulate the absolute level of prices set for VULA but instead set out some high level principles about how the margin between those prices and BT's prices for retail services based on VULA (commonly referred to as the "VULA margin") should be assessed.

22. The regulation of VULA next arose in the fixed access market reviews that Ofcom undertook during 2013 and 2014. In the consultation document dated 3 July 2013 and entitled '*Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30* (the "2013 FAMR Consultation"), Ofcom identified three price squeeze scenarios as possible sources of concern[3] (corresponding to the three remedial options that it ultimately identified in the Statement). Following consultation, it published a statement entitled '*Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30'* in June 2014 (the "2014 FAMR Statement"). Ofcom decided that BT would continue to possess SMP in the relevant wholesale local access market (the "WLA market") and that BT should continue to be required to provide wholesale access to its fibre network in the form of VULA with pricing flexibility as to the absolute level of the VULA price. At that stage, some stakeholders asked for greater clarity on how Ofcom would assess a potential price distortion.

23. Also in June 2014, in a document entitled '*Fixed Access Market Reviews: Approach to the VULA margin*' (the "2014 VULA Margin Consultation"), Ofcom consulted on a set of proposals for regulating the margin between BT's wholesale VULA and retail SFBB prices. Ofcom considered that a greater degree of regulatory and market certainty was necessary to support effective retail competition. There were a number of different ways of achieving this, but ultimately Ofcom chose to use an SMP condition imposing a specific control on the VULA margin, supplemented with detailed guidance. It considered that this approach would limit the opportunities for gaming and disputes and therefore provide greater certainty for stakeholders.

[3] See paragraph 11.288 of the 2013 FAMR Consultation.

24. Following consideration of stakeholder responses to the 2014 VULA Margin Consultation, Ofcom notified the European Commission of its proposals on 15 January 2015 as required under Article 7 of the FD. After receiving comments from the European Commission, it published the Statement on 19 March 2015.

The Statement

25. The Statement sets out Ofcom's approach to regulating the VULA margin in the 2014 to 2017 market review period.

26. Following an executive summary and introduction in Sections 1 and 2, Section 3 of the Statement explains why Ofcom considers, against the background of the legal framework and in light of its market analysis, that there is a relevant risk of adverse effects arising from price distortion in that BT might so impose a price squeeze as to have adverse consequences for end users of public electronic communications services.

27. Ofcom notes that its assessment is structured on the basis that a relevant risk of adverse effects arising from price distortion can be identified where (absent regulation):
    (i) BT has the *ability* to impose a price squeeze;
    (ii) BT has the *incentive* to impose a price squeeze;
    (iii) there is no other factor in the market which would *remove the risk* of a price squeeze; and
    (iv) if realised, this risk will have *adverse consequences for the end users* of public electronic communications services.

28. The approach stated in points (i) – (iii) above follows the Tribunal's judgment in *Hutchison 3G (UK) v Ofcom* ("*Hutchison 3G (CAT)*") [2008] CAT 11 at [286].

29. Ofcom concludes that BT has the ability to impose a price squeeze by reason of its SMP in the WLA market: Statement paragraphs 3.60 – 3.63. BT does not contest the finding of SMP, though it does contest its implications.

30. Ofcom then concludes that there is a "significant and real risk" that BT has the incentive to impose a price squeeze (Statement, paragraph 3.64) based on the immediate and long term competitive advantages (marketing, enhanced scale and weakened competitive pressure) that BT could gain in the expanding SFBB segment from raising its rivals' costs and deterring their future investment in that segment: Statement, paragraphs 3.64-3.76.

31. That risk is not, in Ofcom's assessment, removed by any other factor in the market. Specifically, Ofcom rejects BT's representations that either existing legal and regulatory constraints or prospects for increased competition would have that effect: Statement, paragraphs 3.77 – 3.82 and Section 4.

32. Finally, Ofcom concludes that any price squeeze by BT would have adverse consequences for users in a number of respects within and beyond the period under review (Statement, paragraphs 3.83 – 3.89): (i) competitive pressures would diminish to the detriment of consumers in terms of price and a range of non-price factors; and (ii) consumer choice and innovation would both be reduced. Such conduct could, furthermore, indicate BT's willingness to punish rivals that compete too aggressively, leading to a further weakening of competitive pressures with similar effects to those already noted.

33. Having reached those conclusions, Ofcom explains its regulatory aim in paragraph 3.93 of the Statement:

> "[O]ur regulatory aim is to address this risk: that is, to promote competition by ensuring that BT cannot use its SMP in the WLA market to set the VULA margin over the period of the market review such that it causes retail competition in SFBB to be distorted by virtue of imposing a price squeeze which has adverse consequences for end users of public electronic communications and services."

34. Ofcom considered three options (corresponding to the potential concerns identified in the 2013 FAMR Consultation, noted in paragraph 22 above) to achieve its regulatory aim as set out in the Statement at paragraph 3.100, namely:

Option 1: to ensure that BT 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 SFBB offers.

Option 2: to ensure 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 SFBB offers.

Option 3: to ensure that BT does not set the VULA margin such that it prevents an operator as described in Option 2 being able to profitably undercut significantly BT's retail SFBB offers.

35. All three options were based on a long run incremental cost (or "LRIC") assessment. "Incremental cost" means the extra cost of producing an additional product or service over a specified period of time. Option 1, being based on BT's own costs, was described as an implementation of the "equally efficient operator" (or "EEO") principle: equating in this instance to a LRIC standard. As Options 2 and 3 involve upward adjustments to BT's costs, they were referred to as "adjusted EEO", equating in this instance to a LRIC+ standard.

36. As Ofcom explained at paragraph 3.101 of the Statement, Options 2 and 3 (based on LRIC+) would be likely to require BT to have a higher VULA margin than would be necessary to achieve Option 1 (based on LRIC) . This higher margin would enable rival retailers with slightly higher costs or some other slight commercial drawback relative to BT to compete in the retail provision of SFBB. BT argued in response to the 2014 VULA Margin Consultation that Ofcom was wrong to reject Option 1. In the event, Ofcom decided to impose a price control in terms of Option 2.

37. Section 4 considers whether in light of Ofcom's regulatory aim, it is appropriate to impose some form of regulation to control the VULA margin.

Ofcom first considers whether competition law is sufficient to address its aim and then sets out its conceptual approach to *ex ante* margin regulation.

38. Section 5 sets out the detail of the VULA margin assessment; Section 6 discusses the treatment of costs and revenues and Section 7 sets out Ofcom's overall conclusions.

4. APPROACH TO THE DETERMINATION OF GROUND 1

Principles that inform the Tribunal's approach

39. Appeals against decisions by Ofcom to set SMP conditions (including price controls) are brought under section 192 of the 2003 Act. Section 192(6) requires the appellant to set out the grounds of appeal in sufficient detail to indicate to what extent (if any) the appellant contends that the decision appealed against is based on an error of fact or is wrong in law or both, and to what extent (if any) the appellant is appealing against the exercise of discretion.

40. Section 195(2) provides that the Tribunal "shall decide the appeal on the merits and by reference to the grounds of appeal set out in the notice of appeal". The meaning of an "appeal on the merits" under section 195 has been considered in a number of cases, for example in *British Telecommunications Plc v Ofcom* [2010] CAT 17 (appeal dismissed, [2011] EWCA Civ 245):

> "70. …the first limb of section [195](2) quite clearly requires that the appeal be conducted "on the merits" and not in accordance with the rules that would apply on a judicial review. This point was very clearly made in *Hutchison 3G UK Limited v Office of Communications* [2008] CAT 11 at paragraph [164]:
>
> > 'However, this is an appeal on the merits and the Tribunal is not concerned solely with whether the 2007 Statement is adequately reasoned but also with whether those reasons are correct. The Tribunal accepts the point made by H3G in their Reply on the SMP and Appropriate Remedy issues that it is a specialist court designed to be able to scrutinise the detail of regulatory decisions in a profound and rigorous manner. The question for the Tribunal is not

whether the decision to impose a price control was within the range of reasonable responses but whether the decision was the right one.'

We consider that this correctly states the legal consequences of section 193(2).

71. That said, Jacob LJ in *T-Mobile (UK) Limited v Office of Communications* [2008] EWCA Civ 1373 made absolutely clear that the Section 192 Appeal Process is not intended to duplicate, still less, usurp, the functions of the regulator. In paragraph [31], he stated:

> 'After all it is inconceivable that Article 4 [of the Framework Directive], in requiring an appeal which can duly take into account the merits, requires Member States to have in effect a fully equipped duplicate regulatory body waiting in the wings just for appeals. What is called for is an appeal body and no more, a body which can look into whether the regulator had got something materially wrong. That may be very difficult if all that is impugned is an overall value judgment based upon competing commercial considerations in the context of a public policy decision.' "

41. A more comprehensive summary of the applicable principles may be found in *British Sky Broadcasting Ltd and others v Ofcom* [2012] CAT 20 (the "*Pay TV* judgment") (a case which concerned an appeal from a decision by Ofcom under section 316 of the 2003 Act) at [84]:

> "… [W]e consider that the following principles should inform our approach to disputed questions upon which Ofcom has exercised a judgment of the kind under discussion:
>
> (a) Since the Tribunal is exercising a jurisdiction "on the merits", its assessment is not limited to the classic heads of judicial review, and in particular it is not restricted to an investigation of whether Ofcom's determination of the particular issue was what is known as *Wednesbury* unreasonable or irrational or outside the range of reasonable responses.
>
> (b) Rather the Tribunal is called upon to consider whether, in the light of the grounds of appeal and the evidence before it, the determination was wrong. For this purpose it is not sufficient for the Tribunal simply to conclude that it would have reached a different decision had it been the designated decision-maker.
>
> (c) In considering whether the regulator's decision on the specific issue is wrong, the Tribunal should consider the decision carefully, and attach due weight to it, and to the reasons underlying it. This follows not least from the fact that this is an appeal from an administrative decision not a *de novo* rehearing of the matter, and from the fact that Parliament has chosen to place responsibility for making the decision on Ofcom.

(d) When considering how much weight to place upon those matters, the specific language of section 316 to which we have referred, and the duration and intensity of the investigation carried out by Ofcom as a specialist regulator, are clearly important factors, along with the nature of the particular issue and decision, the fullness and clarity of the reasoning and the evidence given on appeal. Whether or not it is helpful to encapsulate the appropriate approach in the proposition that Ofcom enjoys a margin of appreciation on issues which entail the exercise of its judgment, the fact is that the Tribunal should apply appropriate restraint and should not interfere with Ofcom's exercise of a judgment unless satisfied that it was wrong."

42. This statement of the principles that inform the Tribunal's role was endorsed by the Court of Appeal on appeal[4] and is not in dispute in this case.

43. Within the framework of those principles, there is also no dispute that, as stated by the Tribunal in *Vodafone v Ofcom* [2008] CAT 22 at [46]:

> "… [I]t is … incumbent on Ofcom, in light of their obligations under section 3 of the CA 2003, 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 an appeal on the merits under section 192 of the CA 2003." (emphasis added).

Application to the present case

44. Although these basic principles are not in dispute, there are certain implications that may usefully be clarified.

45. The first arises from the way in which BT puts its case. The first element of Ground 1 is that the market analysis in Section 3 of the Statement is wholly inadequate to withstand 'profound and rigorous scrutiny'. However, the degree of scrutiny that the Tribunal applies is not a ground of appeal in its own right. As noted above, section 192(6) provides that the grounds of appeal must set out in sufficient detail to what extent (if any) the appellant contends that the decision appealed against is based on an error of fact or is wrong in law or both; and to what extent (if any) the appellant is appealing against the exercise

[4] [2014] EWCA Civ 133 at [88].

of a discretion. Allegations that Ofcom's analysis 'does not withstand profound and rigorous scrutiny' are more appropriately formulated and particularised as errors of law, fact or the exercise of discretion. In the present case, we consider the detailed contentions under this part of Ground 1 in part 5 below.

46. Secondly, Ground 1 is confined to the threshold question arising under section 88(1)(a) as to the existence of a relevant risk of adverse effects arising from a price distortion. The remaining grounds of BT's appeal go to the design question arising under section 88(1)(b). As Mr Thompson QC (who appeared for BT) rightly acknowledged during the hearing, there are times when submissions and evidence as to the threshold question may stray into design issues. It is important, in the present context, to avoid being drawn down that path. The consideration of the threshold question should not be extended in a way that pre-empts matters that properly fall to be considered by the CMA when it is considering the specified price control matters.

47. Thirdly, the Tribunal's review must be undertaken by reference to the question under examination. Where, as here, that question concerns the existence of a relevant risk, it is important to avoid an over-zealous application of the 'profound and rigorous review' principle that has the effect of raising the threshold beyond that stipulated by the legislation.

5 ISSUES RAISED BY GROUND 1

48. We now turn to consider the issues raised by Ground 1 of BT's amended Notice of Appeal; for convenience we group these under the five separate headings outlined in paragraph 7 above.

5(A) Did Ofcom adopt the wrong approach to the assessment of relevant risk of adverse effects arising from a price squeeze?

Introduction

49. BT contends that Ofcom's market analysis must demonstrate (in a fashion that withstands profound and rigorous scrutiny) that there is a realistic likelihood that BT might cause harm to end-users through a price squeeze. The focus of the assessment should be on the harm to end-users: the price squeeze is merely the mechanism by which that harm would be effected. The fact that BT's retail margin may not cover its retail costs, or that competitors' interests may be prejudiced by a price squeeze (even to the point that some competitors exit, or some potential competitors do not enter, the retail market) does not mean that end users will be harmed: to the contrary, they benefit from the intensified competition. Harm to end-users will only arise if competitors are so marginalised that they cannot exercise an effective competitive constraint on BT. Ofcom has not demonstrated there is a realistic likelihood that that will happen or that the retail market will cease to be vigorously competitive. That being so, the threshold condition is not satisfied.

50. BT's case is based on the following central propositions:

(i) Ofcom's regulatory power to impose SMP conditions under section 88 should be interpreted restrictively;

(ii) A price squeeze for the purposes of section 88 is to be given the same meaning as a margin squeeze as defined by the jurisprudence of the Court of Justice of the European Union ("CJEU") on the application of Article 102 TFEU;

(iii) A price squeeze only gives rise to a price distortion for the purposes of section 88 where it has a *probable or likely* adverse effect on end-users.

51. Ofcom takes issue with those contentions, maintaining that BT's interpretation conflicts with the essential purpose of the regulatory scheme established in the CRF to promote and maintain sustainable competition. Moreover, it is not in line with the wording of section 88, which requires Ofcom to demonstrate that it believes, on the basis of its market analysis, that there is a relevant risk BT

might (or, in the wording of the AD, *may*) engage in a price distortion (that is, a price squeeze with adverse consequences for end-users). The issues to which BT's contentions gives rise are considered below.

Proposition (i): Are Ofcom's SMP powers to be interpreted restrictively?

Arguments of the parties

52. BT submits that a restrictive interpretation of Ofcom's SMP powers is directed by the CRF and is consistent with the Tribunal's own case law, the case law of the CJEU as well as Ofcom's own regulatory policy and good regulatory practice more broadly.

53. BT emphasises that the CRF comprises, first and foremost, a set of measures designed to open the national markets in electronic communication systems and services with a view to establishing a single internal market operating under harmonised regulatory standards. In such a context, the emphasis is upon maximising individual operators' freedom of action with the correlative consequence that any restraints on such freedom should be kept to a minimum.

54. BT submits that that approach to interpretation is reflected in the Tribunal's reference to the "stringent conditions" that have to be satisfied before the SMP powers can be exercised: see *Telefónica v Ofcom* [2012] CAT 28 at [25] (quoted at paragraph 68 below). BT also refers to the case law of the CJEU, exemplified by Case C-16/10 *The Number UK and Conduit Enterprises v Ofcom* [2011] ECR I-691, as indicative of a refusal on the part of the CJEU to extend the scope of the SMP powers beyond their strictly defined limits.

55. The restrictive approach to interpretation, BT contends, reflects sound policy. In support of that proposition, BT refers to Ofcom's own publication, *Better Policy Making – Ofcom's Approach to Impact Assessment* (21 July 2005), in which the first paragraph endorsed that approach:

> "One of our key regulatory principles is that we have a bias against intervention. 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." (paragraph 1.1)

56. Furthermore, BT suggests that sound regulatory policy favours a reliance on *ex post* competition law to *ex ante* sector regulation, as evidenced by the opinion of Alex Chisholm (Chief Executive of the CMA and, previously, a telecoms regulator) that:

> "…[T]he significant risks associated with premature, broad-brush *ex ante* legislation or rule-making point towards a need to shift away from sector-specific regulation to *ex post* antitrust enforcement, which is better adapted to the period we're in, with its fast-changing technology and evolving market reactions."

57. Ofcom does not dispute the market-opening purposes of the CRF but is of the opinion that the CRF itself and the other material cited by BT do not limit the scope of powers expressly conferred by the CRF or their proper application in accordance with their terms.

The Tribunal's assessment

58. Section 88 implements the corresponding provisions of the CRF and is to be interpreted in a manner consistent with those provisions. No suggestion of inconsistency has been made by BT nor could it plausibly have been made in view of Lord Sumption's observation in an earlier case to which BT was a party that "*it is common ground that the [CRF] Directives are accurately transposed in the [2003] Act"* (*BT v Telefónica et al (080 numbers)* [2014] UKSC 42 at [14]). Consequently, to make good the point that section 88 is to be given a restrictive interpretation, BT must demonstrate that the corresponding provisions of the CRF are to be given such an interpretation.

59. The definition of a price distortion in section 88(3)(b) of the 2003 Act reflects AD, Article 13(1) which states that SMP conditions may be imposed where "*a lack of effective competition means that the operator concerned … may apply a price squeeze, to the detriment of end-users*." Although the AD does not

define a price squeeze, it contains the following descriptive reference in Recital (20) upon which Ofcom relied in the Statement at paragraph 3.4, footnote 35:

> "[O]perators with significant market power 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*." (emphasis added)

60. The regulation of markets affected by such price distortions falls within the overall framework established by Article 8 of the FD which lays down the fundamental policy objectives and regulatory principles that an NRA such as Ofcom is obliged to follow, namely (in summary):

(i) to promote competition in the provision of electronic communications networks and services and in associated facilities and services (Article 8(2));

(ii) to contribute to the development of the internal market (Article 8(3)); and

(iii) to promote the interests of EU citizens (Article 8(4)).

Section 4 of the 2003 Act obliges Ofcom to act in accordance with these "Community requirements" when carrying out its functions including those in issue in this case.

61. Recital (25) of the FD states that "*there is a need for ex ante obligations in certain circumstances in order to ensure the development of a competitive market*." Those circumstances are, as BT submitted, so defined as to ensure that regulation within the market does not exceed that which is required for its proper development and operation.

62. The latter objective is accomplished principally by the limitation of *ex ante* obligations to cases in which SMP is established. The policy is stated in Recital (27) of the FD:

> "It is essential that *ex ante* regulatory obligations should only be imposed where there is not effective competition, i.e. 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. …"

It is then implemented by FD, Article 16(3) and (4):

> "(3) Where a national regulatory authority concludes that the market is effectively competitive, it shall not impose or maintain any of the specific regulatory obligations referred to in paragraph 2 of this Article [*which includes the price control obligations in AD Article 13*]. …
>
> (4) Where a national regulatory authority determines that a relevant market is not effectively competitive, it shall identify undertakings which individually or jointly have a significant market power on that market … and the national regulatory authority shall on such undertakings impose appropriate specific regulatory obligations referred to in paragraph 2 of this Article [*which includes the price control obligations in AD Article 13*]… "

63. In our judgement, neither the purposes nor the specific drafting of the CRF support the proposition that the legislative provisions conferring the SMP powers in issue should be interpreted restrictively. The evident concern to avoid the use of SMP powers in circumstances where there is effective competition (see paragraph 62 above) does not direct a restrictive approach to the imposition of SMP conditions in circumstances such as those that obtain in this case, where it follows from BT's acceptance that it has SMP on the WLA market that there is not effective competition.

64. Still less are we persuaded of that proposition by provisions such as those to be found in Article 8 of the FD which enjoin NRAs to promote effective competition. In circumstances where effective competition does not presently exist, we take such provisions to direct the appropriate use of SMP powers rather than their non-use. That position is confirmed, in our view, by Article 8(2) of the AD which provides that:

> "Where an operator is designated as having significant market power on a specific market …, national regulatory authorities *shall* impose the obligations set out in Articles 9 to 13 of this Directive as appropriate." (emphasis added)

65. The statement in Recital (27) of the FD (quoted in paragraph 62 above) that "*ex ante regulatory obligations should only be imposed … where national and Community competition law remedies are not sufficient to address the*

problem. …" clearly indicates a specific purpose to remedy gaps left by EU or national competition remedies.

66. To the extent that restraint is required in the exercise of those powers, that is expressly provided for in AD Article 8(4):

> "Obligations imposed in accordance with this Article shall be based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of [the] Framework Directive. …"

67. That provision is reinforced by the general principle of EU law (commonly identified by reference to *MAFF ex parte Fedesa*[5] and applied in this Tribunal under the soubriquet of the *Tesco* principle[6]), which requires that administrative action should be limited to that which is necessary to pursue a legitimate aim, least burdensome to the affected undertakings and proportionate to the costs incurred.

68. None of the foregoing conclusions are altered by the other material to which BT refers. With respect to the Tribunal's case law, BT particularly relies upon *Telefónica v Ofcom* [2012] CAT 28 at [25] where the Tribunal said:

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

69. That observation echoes the remarks of the Tribunal in *Hutchison 3G (CAT)* at [150]:

> "H3G characterised these provisions as imposing stringent pre-conditions for the imposition of a price control condition because price control is a highly intrusive form of regulation which may have unintended adverse consequences, both for the company being regulated and, more generally, for competition. H3G stressed that the implications for a business of not being able to set the price for its own service over a four year period in a dynamic and fast-changing market are very severe and we do not understand that Ofcom disagreed with this description of the statutory scheme."

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[5] Case C-331/88 *R v Ministry of Agriculture, Fisheries and Food and Secretary of State for Health ex parte Fedesa* [1990] ECR I-4023.
[6] *Tesco Plc v Competition Commission* [2009] CAT 6, [137]-[139] and [143].

70. We note that the reference to "these provisions" in the latter citation embraces not only section 88 as a whole but the suite of price control provisions including the prior finding of SMP: see *Hutchison 3G (CAT)* at [147] – [150]. Moreover, neither judgment focuses on the threshold question. In any event, adopting Ofcom's submission in relation to *Telefónica*, we conclude that both observations are descriptive rather than interpretative – and, as such, they are not controversial.

71. Turning to the jurisprudence of the CJEU, BT referred to paragraphs 30 and 31 of that Court's judgment in *The Number v Ofcom* in which the Court said that order-making powers that arose by way of exception should be interpreted strictly.[7] That statement, however, does not provide any basis for limiting the exercise of SMP powers in respect of the activities of an undertaking to which the finding of SMP relates: on the contrary, that is precisely the case envisaged by FD, Article 16(4), quoted in paragraph 62 above.

72. The policy materials BT cites (summarised in paragraphs 55-56 above) cannot limit the scope of powers properly deduced from their terms. They have no legislative force. Moreover, even taken at their strongest, they represent positions taken within a single Member State which cannot alter the interpretation of Union legislation. In any event, neither citation does anything more than enjoin the due care and proportion in the application of these powers which is already stated in the legislation and required by the general principles of law noted above.

73. For these reasons, we are not persuaded by BT's arguments. In our view, there is no good reason for taking the restrictive approach to the interpretation of SMP powers for which BT contends.

[7] The case concerned the power under the Authorisation Directive (2002/20/EC) to impose obligations on undertakings designated to provide universal service. The specific question at issue was whether that power was limited to the universal service that the designated undertaking provided or extended to the regulation of other services provided by the designated undertaking in order to promote the provision of universal services by others.

Propositions (ii) and (iii): Arguments and evidence

74. BT's case is based on the central claim that the meaning of a price squeeze is to be determined in accordance with the jurisprudence of the CJEU relating to the application of Article 102 TFEU to margin squeezes. As noted above, that claim comprises two propositions, the first (proposition (ii) in paragraph 50 above) as to the meaning of a price squeeze and the second (proposition (iii) in paragraph 50 above) as to the foreseeability that such a price squeeze will have an adverse effect on end users. We structure our discussion in three parts. This part sets out the arguments of the parties and the supporting evidence in relation to both propositions. The following parts set out our assessment of the arguments in relation to each of the propositions separately.

75. BT submits that the jurisprudence of the CJEU conclusively establishes the following binding principles in respect of all pricing abuses including a price squeeze in the context of the CRF:

(i) The legality of a dominant firm's pricing practices must be determined by reference to its own costs and pricing strategy (citing Case C-280/08P *Deutsche Telekom v Commission* [2010] ECR I-9555 at [198] and Case C-52/09 *Konkurrensverket v TeliaSonera Sverige* [2011] ECR I-527 at [41]).

(ii) A dominant firm's prices only infringe EU competition law where they satisfy any of the criteria set out in points (iii) and (iv) below (citing Case C-202/07P *France Télécom v Commission* [2009] ECR I-2369 at [109] and the operative part of the judgment in Case C-209/10 *Post Danmark v Konkurrencerådet* [2012] 4 CMLR 23 ("*Post Danmark I"*)).

(iii) A dominant firm's prices infringe EU competition law where they are set at a level that does not cover its average variable costs (citing *France Télécom* as above).

(iv) A dominant firm's prices also infringe EU competition law where they cover its average variable costs but do not cover its total costs and either:

(a) they form part of a deliberate exclusionary strategy (citing *France Télécom* as above); or

(b) they produce an actual or likely exclusionary effect, to the detriment of competition and, thereby, of consumers' interests (citing *Post Danmark I* as above).

(v) In a case based on anticipated exclusionary effects, those effects must at least be demonstrably likely or probable (citing the judgments in *Post Danmark I* as above and Case C-23/14 *Post Danmark v Konkurrencerådet* [2015] 5 CMLR 25 ("*Post Danmark II"*) at [74]).

(vi) A prospective analysis requires great care, recognizing the predictive nature of an exercise in which it is necessary to consider the various chains of cause and effect with a view to ascertaining which of them are the most likely (citing the judgment to that effect in Case C-12/03P *Commission v Tetra Laval BV* [2005] ECR I-987 at [42] –[43]).

76. Points (i) – (iv) correspond to proposition (ii) as to the meaning of a price squeeze. In the present case, BT submits that no attempt had been made to establish that BT will engage in a pricing strategy falling within points (iii) or (iv)(a). The only suggestion is that BT may engage in a pricing strategy that will have an exclusionary effect, so falling within point (iv)(b). BT submits that this argument, however, must fail for multiple reasons, including that (contrary to point (i)) potential price squeezes have not been assessed on the basis of BT's own costs but on an adjusted version of those costs, and (contrary to points (i) and (iv)), the proposed condition is based on a cost threshold that exceeds BT's own total costs.

77. Ofcom contends that BT's propositions do not provide an accurate statement of the Article 102 jurisprudence in relation to margin squeeze: the cases relied upon are not authority for the proposition that specific tests applicable to other

types of pricing abuse (such as predatory pricing) are also applicable to margin squeeze. More fundamentally, Ofcom does not accept BT's basic premise that the Article 102 jurisprudence is determinative in relation to the concept of a price squeeze. That concept has its own standard (expressed in Recital (20) to the AD quoted at paragraph 59 above) which, with its reference to ensuring the maintenance of sustainable competition, is more inclusive than the standard for a margin squeeze.

78. Points (v) and (vi) in paragraph 75 above correspond to proposition (iii) as to the foreseeability that a price distortion will have an adverse effect on end-users. BT maintains that Ofcom must show that there is a realistic likelihood *both* that BT will engage in a price squeeze *and* that that squeeze will have an adverse effect on end-users. In that respect, BT also relies upon Case T-201/04 *Microsoft Corporation v Commission* [2007] ECR II-3601 at [561] in support of the proposition that 'risk' and 'likelihood' of elimination of competition are used interchangeably by the Union Courts and the reference to 'risk' in section 88 is, therefore, to be read as a reference to 'likelihood'.

79. Ofcom accepts that it must find that there is a real risk, that is more than a fanciful risk, but rejects any suggestion that the possibility of a price distortion has to be more likely than not, or that more than a risk of harm to end-users has to be established. In saying that, Ofcom emphasises the importance of giving the statutory language its ordinary and natural meaning. Section 88 refers to a "relevant risk" which is defined in terms of a consideration as to whether BT 'might' or 'may' engage in a price squeeze harmful to end-users.

80. In response to the Tribunal's request at the end of the hearing that they clarify their positions in relation to foreseeability, both parties confirmed that they envisaged a unitary test. Ofcom restated its position that it was sufficient to demonstrate that there is a realistic risk of harm to end-users arising from a price squeeze – which imported that it is sufficient that there is a realistic risk that BT will engage in such conduct. BT likewise maintained its position, saying that Ofcom is required to demonstrate that there is a realistic likelihood

of harm to end-users arising from a price squeeze – which imports that it is necessary that there is a realistic likelihood that BT will engage in conduct having that effect.

81. The material relevant to these issues is to be found in the Statement, as summarised at paragraphs 25-38 above.

82. Ofcom's assessment is further explained in the evidence of Mr Matthew (Economic Director at Ofcom). He identifies a variety of ways in which a price squeeze, or the threat of a price squeeze, could distort competition with adverse effects for consumers:

(i) complete or partial foreclosure of competitors, leading to higher prices or less responsive or innovative suppliers;
(ii) short-term distortion of the competitive process, even if subsequent re-entry precluded long-run damage to competition;
(iii) setting a high VULA price to negate rivals' competitive advantages;
(iv) raising the VULA price to expropriate the benefit of rivals' investments; and
(v) raise rivals' perception of risk, so diminishing their appetite to compete or invest.

In the last case, Mr Matthew notes that the mere threat of a price squeeze could be sufficient to have these effects.

83. Of particular relevance to the present issue, Mr Matthew explains that if BT were to raise the VULA wholesale price without a corresponding increase in its retail price, its retail competitors might respond in a variety of ways which would be likely to include raising their SFBB retail prices (thereby reducing their volumes, as BT's relatively more attractive offer causes some customers to switch) or accepting reduced margins for their SFBB products (reducing rivals' incentive to invest in SFBB). In any event, rivals' profits in the SFBB segment would deteriorate, reducing their ability to exploit economies of scale and weakening the competitive constraint on BT. The consequential gains to

BT (both in terms of increased SFBB volumes and reduced competition) would be taken into account by BT, "giving BT a permanent incentive to set higher VULA prices (relative to its retail offers) than it would set if there were no impact on BT's retail division." Moreover, the incentives to deploy this strategy would be particularly strong in the present review period because it is likely to be a critical period in the growth of and transition to SFBB.

84. Two witnesses gave evidence for BT that bears on these issues. Mr Tickel, Head of Operational Regulation and Economics in the BT Group Regulatory Affairs Department, described the existing regulatory framework as one that requires BT to sell VULA "on terms … so it can actually be used by all downstream players",[8] a point that was also reflected in the contrast that he drew between an (implicitly permissible) disagreement on price and an (implicitly impermissible) approach under which Openreach might say "here's a product but, if you buy it, there's no way that you can construct a commercially attractive offer on it that will make you money."[9]

85. Mr Bishop (partner at RBB Economics) prepared two expert reports filed on behalf of BT and gave evidence at the hearing. Mr Bishop's second report comments on Mr Matthew's expert report and highlights a number of areas of disagreement, in particular an undue focus by Ofcom on harm to competitors rather than consumers when the focus should be on whether the harm to competitors would be such that competitors would be unable to win SFBB subscribers at incrementally profitable margins.

86. Mr Bishop stressed the need, in determining whether a price squeeze is anti-competitive, to consider whether the dominant firm's competitor would be able to earn a positive margin.[10] He expanded that observation in discussion with the Tribunal thus:[11]

[8] Transcript Day 2, page 49, line 22.
[9] Transcript Day 2, page 47, lines 6 and 7.
[10] Transcript Day 2, page 86, lines 15-17.
[11] Transcript Day 3, page 18, line 8 – page 20, line 2, *passim*.

(i) In the short-run, a rival's ability to recover short-run incremental costs is decisive.

(ii) That does, however, only provide a partial answer to the rival's position because it is critically important that an entrant has the expectation that long-run incremental costs would be recovered.

(iii) In the present case, he regards short-run incremental costs as decisive for two reasons. First, long-run analysis would be very difficult in a fast moving market. Secondly, the retail broadband market is highly competitive: "so, given that, plus all the difficulties associated with implementing one of these margin squeeze tests, it says you've got to have very strong evidence before I would want to intervene in this marketplace."[12]

87. In closing, Mr Thompson, for BT, adopted Mr Tickel's evidence to formulate the test for a price squeeze in terms of "a margin that means competitors would be unable to compete in the long run" subject to four qualifications, namely that:

(i) the assessment is made by reference to BT's own costs;

(ii) care is required to avoid the risk that retail prices would be raised to the detriment of consumers because competitors are given too much margin;

(iii) it is inappropriate for Ofcom to have as an objective in the imposition or design of a price control an outcome where the market shares in the SFBB segment approximate to those in the SBB segment;

(iv) if the control is to be framed on a short-run (e.g. monthly) basis, the risk assessment should likewise be framed on a short-run basis.[13]

88. Mr Holmes, for Ofcom, agreed that there was no significant difference in the ways in which the CRF and the CJEU's jurisprudence on Article 102 understand the concept of a price/margin squeeze. He noted that the jurisprudence used an EEO test for reasons of legal certainty in an *ex post*

[12] Transcript Day 3, page 19, lines 30 - 32.
[13] Transcript Day 3, page 18, line 19 – page 20, line 14.

context whereas *ex ante* regulation could satisfy that requirement on a basis that used some other measure of downstream costs (such as those of a reasonably efficient operator (or "REO")). In the present case, however, Ofcom had not gone that far, limiting itself to an adjusted EEO standard which only made a small practical difference to the outcome.[14]

Proposition (ii): Tribunal's assessment of the meaning of a price squeeze

89. In this part, we consider the meaning of a section 88 price squeeze. First, we discuss BT's contention that that concept should be assimilated to the concept of an Article 102 margin squeeze: in view of the disagreement between the parties as to the standards to be deduced from the Article 102 jurisprudence, we express our views on that matter before considering the relationship between that jurisprudence and the interpretation of the CRF. We then consider, in the following part, our conclusions as to the interpretation of section 88.

The relevance of the Article 102 jurisprudence

90. The paradigm case of a margin squeeze is described, in paragraph 80 of the Commission's Guidance on its Enforcement Priorities ("Guidance"),[15] as one in which:

> "a dominant undertaking … charge[s] a price for the product on the upstream market which, compared to the price it charges on the downstream market, does not allow even an equally efficient competitor to trade profitably in the downstream market on a lasting basis."

91. We note that the Guidance is not binding on Ofcom or on us (*Post Danmark II* at [52]) but we treat it as a useful point of reference in accordance with the opinion of Advocate General Mazák in *TeliaSonera Sverige* at footnote 21 (and the cases cited there). In any event, it does not identify the boundaries of

[14] Transcript Day 5, page 43, line 12 – page 44, line 34.
[15] Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, 2009 OJ C45/7 (24.2.2009).

margin squeeze cases that may be prohibited under Article 102. For those, we have to refer to the jurisprudence of the CJEU.

92. The Court has consistently held that Article 102 is "…*not only aimed at practices which may cause damage to consumers directly, but also at those which are detrimental to them through their impact on an effective competition structure*" (generally termed "exclusionary abuses"): Case 6/73 *Europemballage Corporation and Continental Can Co Inc. v Commission* [1974] ECR 223 at [26].

93. The principles applicable to exclusionary abuses were synthesized and restated by the Grand Chamber of the CJEU in *Post Danmark I* (at [21]-[25] and [40]-[42]). The following general principles derive from that judgment:

(i) Article 102 is concerned with the protection of competition on the merits and the promotion of efficiency and, thereby, with the enhancement of consumer welfare in relation to features that include price, choice, quality and innovation.

(ii) Accordingly:

(a) Article 102 does not prohibit conduct that constitutes competition on the merits even if it results in the acquisition of a dominant position or the exclusion or marginalisation of competitors that are less efficient or attractive to consumers than the dominant firm; but

(b) Article 102 does prohibit conduct that has the effect of impairing competition on the merits, in particular where that conduct has the effect of strengthening the market position of the dominant firm or diminishing actual or potential competition to the detriment of consumers.

(iii) However, Article 102 does not apply to conduct that would otherwise be prohibited if it can be shown by the dominant firm to be either objectively necessary or indispensable to produce efficiency gains that

yield benefits to consumers that outweigh the negative effects of the conduct in question without eliminating effective competition by removing all or most sources of actual or potential competition.

94. In the interests of effective enforcement and legal certainty, the principles stated in points (i) and (ii) of the preceding paragraph have to be rendered administrable through more precise legal standards. In relation to pricing conduct (including a margin squeeze), the jurisprudence indicates that:

(i) Article 102 prohibits a dominant firm's pricing strategy where it does not constitute competition on the merits[16] and has an anti-competitive effect as described in point (ii)(b) of paragraph 93: Case C-62/86 *AKZO v Commission* [1991] ECR I-3359 at [70]; *France Télécom* at [106]; *Deutsche Telekom* at [177]; *Post Danmark I* at [25].

(ii) In general (but not invariably), the legality of a firm's pricing conduct should be assessed by reference to its own costs: *TeliaSonera Sverige*, at [41], citing *AKZO* at [74] and *France Télécom* at [108] and [45].

(iii) The anticompetitive effect must be likely or probable but need not have materialised at the time of the decision: *Post Danmark II* at [65]–[66] and [69]-[74].

(iv) In assessing whether that effect arises, it is necessary to examine all the circumstances of the case and specifically to investigate whether the practice impairs buyers' freedom of choice, forecloses competitors, discriminates amongst counterparties, or strengthens the dominant position by distorting competition: *TeliaSonera Sverige* at [28].

95. Within that framework, the following standards specifically applicable to margin squeezes have been identified:

[16] We use the term "competition on the merits", employed in the two most recent cases cited, in preference to the reference to "quality" that was employed in the older cases. In substance, we consider them to be synonymous.

(i) A margin squeeze has an anti-competitive effect where it is such that a competitor cannot trade profitably in the downstream market on a lasting basis (*Deutsche Telekom* at [252]-[253]), thereby preventing or restricting its access to or growth on that market: *Deutsche Telekom* at [234] and *TeliaSonera Sverige* at [70].

(ii) That condition has to be assessed by reference to the indispensability of the dominant firm's upstream product to operating on the downstream market and the intensity of the squeeze on the downstream competitor's margin: *TeliaSonera Sverige* at [69] and [73]. In that connection:

(a) Where indispensability is coupled with a negative downstream margin[17] an exclusionary effect is probable: *TeliaSonera Sverige* at [70] and [73].

(b) Where indispensability is coupled with a positive downstream margin, an exclusionary effect arises where, by reason of reduced profitability or otherwise, it is likely that it would be more difficult for the downstream competitor to trade on that market: *TeliaSonera Sverige* at [70] and [74].

(c) A margin squeeze may have an exclusionary effect even if there are alternative means of obtaining the upstream product: *TeliaSonera Sverige* at [72].

(d) A margin squeeze may exist even though neither the upstream prices nor the downstream prices are themselves abusive: Case T-336/07, *Telefónica* [2012] 5 CMLR 20 at [187].

96. With those principles in mind, we consider BT's submissions with respect to the standards applicable to margin squeezes. We agree that, in the circumstances of this case, a margin squeeze only arises if an exclusionary effect is shown to be probable or likely. An exclusionary effect arises,

[17] In this context, a negative margin is identified where the dominant firm's price for the upstream product exceeds its price for the downstream product.

however, where the pricing strategy distorts the competitive process in a way that renders entry or expansion by rivals more difficult, or may lead to the exit of existing competitors, thereby diminishing the intensity of competition over the long term and so disadvantaging consumers.

97. Ordinarily, the existence of a margin squeeze is determined by reference to the dominant firm's own costs. The use of that criterion is, however, significantly influenced by the fact that Article 102 articulates a generally applicable standard that is predominantly enforced *ex post*. First, it reduces the risk of assessment errors because it "*mean[s] that competitors who might be excluded by the application of the pricing practice in question could not be considered to be less efficient than the dominant undertaking and, consequently, that the risk of their exclusion was due to distorted competition*" (*TeliaSonera Sverige* at [43]). Secondly, it is consistent with the requirements of legal certainty: *TeliaSonera Sverige* at [44]. Despite those factors, it is not determinative in all cases. In the context of margin squeeze specifically, it may be set aside for reasons of unavailability or unsuitability of the dominant firm's cost information: *TeliaSonera Sverige* at [45]. More generally, the CJEU has recently observed that the "equally efficient competitor" principle may be irrelevant where the dominant position is of such strength and persistence that the emergence of an equally efficient competitor is practically impossible or a less efficient competitor may contribute to maintaining competitive constraints on the dominant firm: *Post Danmark II* at [59]–[62]; the Court has yet to consider whether and how that qualification would apply where the abuse affects a market other than that on which the dominant position exists.

98. BT places great stress on the requirement that the exclusionary effect should be a likely or probable consequence of the impugned conduct. Whilst that is established in *Post Danmark II*, the meaning of those terms is far from clear. Although Advocate General Kokott said that the effect must be more likely than not (Opinion, paragraph 82), the Court neither adopted nor rejected that view. By contrast, in the present case, BT suggests, by way of illustration, that a 40% probability might suffice to establish likelihood. In any event, in the

present context, the required level of foreseeability is a distinct issue to be determined in accordance with the terms of the statute which are discussed under proposition (iii).

99. It is also uncertain whether the anti-competitive effect in a margin squeeze case has to be appreciable. Whilst the CJEU has rejected that requirement in the context of Article 102 (*Post Danmark II* at [72]–[74]), Roth J subsequently held, in *Streetmap.EU Ltd v Google Inc* [2016] EWHC (Ch) 253 at [95]-[98], that that judgment did not necessarily exclude a materiality requirement in a case where the conduct affected a market on which the firm was not dominant, especially where the impugned conduct had a pro-competitive effect on the dominated market. In any event, that question does not bear on the construction of section 88 which includes the requirement of harm to end-users: in our judgement, the mere prospect of *de minimis* harm to end-users would be insufficient to satisfy that requirement.

100. As noted in paragraph 93(iii) above, a dominant firm may rely upon defences of objective necessity or economic justification. That possibility would only be relevant if BT sought to maintain that every likely instance of a price squeeze was objectively necessary or indispensable to realising proved efficiency gains. BT has neither advanced that argument (relying instead on the absence of *prima facie* exclusion altogether) nor adduced any specific evidence to support such an argument. Accordingly, we conclude that the possibility of these defences is not material to the present consideration.

<u>The partial overlap between the CRF and Article 102</u>

101. There is no dispute that the CRF and competition law serve overlapping purposes. Both systems of regulation are founded on the Union's commitment, under Article 3(3) of the Treaty on the European Union ("TEU"), to establish an internal market: see, respectively, the legal base for the CRF (Article 114

TFEU (*ex* Article 95 EC))[18] and Protocol 27 to the TEU/TFEU.[19] Within the broad internal market objective, both the CRF and competition law pursue the specific goals of competition, efficiency and consumer welfare (the key parameters in section 88(1)): see, respectively, FD Article 8 and the paragraph 5 of the Commission's Guidance.[20]

102. The broad purposes of the CRF have been confirmed by both the CJEU and the Supreme Court. Summarising the case law in *BT v Telefónica et al (080 numbers)* [2014] UKSC 42 at [10], Lord Sumption observed that:

> "The scheme of the Directives has been considered on a number of occasions by the Court of Justice of the European Union. … It can fairly be summarised as follows. The objectives of the scheme are set out in Article 8 of the Framework Directive, and in particular in Article 8.2, which assumes that *consumer welfare will generally be achieved by competition* and requires national regulatory authorities to promote both." (emphasis added, internal citations omitted)

103. The overlap between the two regimes is reinforced by the express assimilation of the concept of SMP to that of a dominant position under Article 102, as stated in Recital (25) and Article 14(2) of the FD.

104. By stating that *ex ante* remedies should be adopted "*where national and Community competition law remedies are not sufficient to address the problem*", Recital (27) of the FD (quoted in paragraph 62 above) makes clear both the existence of the overlap between the two regimes and its partial nature. Whilst the insufficiency may clearly relate to the nature or timing of the remedies, we do not take the terms of Recital (27) to import a limitation of the SMP powers to such cases. In particular, we do not consider that those terms import a requirement to equate the definitions of a price squeeze and a

[18] Article 114 TFEU provides for the adoption of measures, to harmonise national legislative and administrative action, which have as their object the establishment and functioning of the internal market.

[19] Protocol 27 records that "the internal market as set out in Article 3 TEU includes a system ensuring that competition is not distorted."

[20] "In applying Article 82 to exclusionary conduct by dominant undertakings, the Commission will focus on those types of conduct that are most harmful to consumers. Consumers benefit from competition through lower prices, better quality and a wider choice of new or improved goods and services. The Commission, therefore, will direct its enforcement to ensuring that markets function properly and that consumers benefit from the efficiency and productivity which result from effective competition between undertakings."

margin squeeze. A number of factors indicate that that would be an incorrect interpretation of the legislation:

(i) The assimilation of SMP to a dominant position indicates that the Community legislator clearly had the relationship between the CRF and competition law regimes well in mind. Had it intended to assimilate the cases in which the SMP powers could be employed to cases of abuse of a dominant position, it would have done so.

(ii) It is evident from Article 8 of the FD that the CRF serves a broader range of purposes than the competition law regime. Although (in view of Ofcom's stated regulatory aim quoted in paragraph 33 above) that may be less significant in the present case, the particular circumstances of one case cannot limit the proper definition of regulatory powers in all cases.

(iii) The nature of Article 102, as an *ex post* prohibition regime enforced by significant penalties, has a material effect upon the definition of an abuse - as illustrated by the CJEU's formulation of a margin squeeze in terms of an EEO standard noted in paragraph 97 above. The absence of those factors in the context of *ex ante* powers means that there is no reason to limit them by reference to an EEO standard.

(iv) More generally, it is inherently impossible for a competition law regime, expressed in terms of a generally applicable prohibition, to capture the precise circumstances of each specific case in the way that can be achieved by an *ex ante* appreciation of those circumstances.

105. In view of that discussion, we cannot accept BT's submission that the CJEU's jurisprudence binds Ofcom in the exercise of its SMP powers or is determinative of the meaning of a section 88 price distortion. None of the cases upon which BT relies address that issue or, indeed, are concerned with the circumstances in which the SMP powers may be exercised. Rather, they

are at most concerned with the interpretation and application of Article 102 and equivalent competition law provisions in national law.

106. That said, in our judgement, it would be inappropriate to exaggerate the distinction between the two regimes. In the context of a price or margin squeeze, both Article 102 and the CRF are concerned to prevent the exploitation of upstream market power to distort competition on a downstream market. Moreover, Article 102, like the CRF, is concerned with conduct that affects the growth of competition as well as its maintenance: see *Post Danmark I*, at [24]. It is also evident that Article 102 has an *ex ante* element (in that conduct may be prohibited before its effect materialises) and that that affects the formulation of the applicable standard: see *TeliaSonera Sverige*, at [44].

107. For these reasons, we conclude that, whilst Article 102 and the CRF overlap, the Article 102 jurisprudence is not determinative of the scope and application of the CRF and section 88.

Tribunal's conclusion on the nature of a price squeeze

108. With the foregoing discussion in mind, we now set out our conclusions as to the proper interpretation of a price squeeze within the meaning of section 88.

109. Taking BT's case as stated in Mr Thompson's closing (summarised in paragraph 87 above), there is no disagreement about the central proposition that a price squeeze is to be identified on the basis of a long-run assessment. In our view, BT is correct to put the case in that way and, indeed, the contrary proposition is untenable in view of the description of a price squeeze in Recital 20 AD (referring to a pricing strategy that is inadequate to ensure *sustainable* competition) and the Article 102 jurisprudence discussed above. The points of disagreement, therefore, concern BT's qualifications to that central proposition.

LRIC+ margins

110. BT's principal submission is that the assessment should be made by reference to BT's own costs - in other words, on an EEO (or LRIC) basis. That raises issues at both the threshold stage, excluding even the possibility of intervention on a REO or adjusted EEO (LRIC+) basis, and the design stage. Our concern in this judgment is solely with the first, threshold, stage.

111. In that context, the criteria for a price squeeze have to be identified by reference to the mischief addressed by the legislation, namely the exploitation of SMP on the upstream market to distort competition on the downstream market. An EEO standard captures the paradigm cases where the incumbent firm reduces its downstream margin to a level that fails to cover downstream LRIC. Furthermore, that standard is sufficient to address the case where upstream dominance is the only relevant market distortion. It does not, however, address cases where the incumbent's upstream dominance exists in combination with additional downstream advantages relative to actual or potential competitors and that combination is such that the mischief of a price squeeze may arise without reducing downstream margins to a level below LRIC. There is nothing to indicate that the legislation should be interpreted so narrowly as to exclude such cases, and to do so would substantially limit its utility.

112. That conclusion is not contradicted by the Article 102 jurisprudence. As discussed above, that jurisprudence is not binding in relation to the interpretation of the CRF and is of limited persuasive authority, not least because it is based on considerations of effective administration and legal certainty that are particularly pertinent in the context of an *ex post* prohibition regime. In any event, it is recognised that there are circumstances in which the "equally efficient competitor" principle may be inappropriate in the context of Article 102.

113. In the Statement, Ofcom concluded that a price squeeze might arise in cases where the VULA margin exceeds LRIC in view of the fact that (despite the different advantages and disadvantages enjoyed by all firms) "*there is … a*

potential risk that BT has some advantages (for example, which may be linked to its position as the legacy incumbent) which its rivals are unable to match" (Statement, paragraph 3.99). Such advantages include economies of scale, first-mover advantages or a lack of technical replicability: Statement, paragraph 6.50. In our judgement, Ofcom's conclusion to that effect is consistent, in principle, with the terms of section 88.

LRIC- margins

114. BT's second qualification identified the risk that, under an unqualified LRIC assessment, retail prices would be raised to the detriment of consumers because competitors are given too much margin. That too presents issues at both the threshold stage, where the prospect of LRIC- prices may be sufficient to exclude even the *possibility* of intervention, and the design stage.

115. In this respect, two particular points require attention. The first is the claim (made by Mr Bishop in evidence) that there is no risk of an anti-competitive price squeeze, and indeed consumers gain, from aggressive pricing at LRIC- levels so long as that pricing does not drive out effective competition. The second is a specific application of that general claim based on the proposition that Sky's situation (including particularly its advantages on the upstream content markets) is such that it would not be excluded or weakened if BT were to adopt a LRIC- pricing strategy.

116. The first point presupposes that short-term pricing advantages are the principal concern to be taken into account in determining whether intervention is appropriate. That manifestly fails to take account of the long-term objectives underpinning the concept of a margin/price squeeze under both Article 102 and the CRF. As Mr Bishop recognised in his evidence (see paragraph 86 above), it is critically important that an entrant has the expectation that long-run incremental costs would be recovered. Once it is established that harm to the long-term objectives is sufficiently foreseeable to give rise to a relevant risk, the balancing of those objectives against the short-term pricing impact is a matter that necessarily falls to be considered exclusively at the design stage.

117. We consider that the second point also fails. Even if it were to have merit in relation to the particular position of Sky, it would not be a sufficient basis to exclude the identification of a relevant risk of price distortion. That assessment has to be made by reference to the position of actual and potential competitors more generally, taking as the benchmark a firm in the same position as BT on the downstream market with such adjustments as may be required in accordance with the principles set out in paragraph 111 above.

118. In any event, to the extent that Sky does enjoy unique advantages on an upstream market, it would not be appropriate, in our judgement, to give decisive weight to them at the threshold stage. To do so would lead to the result that, in the case where two firms independently hold dominant positions on different inputs to the same downstream market, neither party's pricing conduct would be open to scrutiny under the legislation by reason of the other party's dominance – thereby, leading to the significant risk of an entrenched duopoly on the downstream market.[21]

Additional factors

119. BT makes three additional points. First, it submits that it is inappropriate for Ofcom to impose a price control with the objective of achieving an outcome under which the market shares in the SFBB segment approximate to those in the SBB segment. Whilst it is correct to say that Ofcom used that comparison as an indicator of the possibility that the SFBB might become unduly concentrated if BT were able to engage in a course of price distortion, we do not think that it was unreasonable to consider the comparison as a factor in its analysis or that it gave such weight to that factor as to invalidate its conclusion that a relevant risk of price distortion existed.

120. The second point BT makes is that, if the control is to be framed on a short-run (e.g. monthly) basis, the risk assessment should likewise be framed on a short-run basis. This argument clearly puts the cart before the horse. The

[21] For the avoidance of doubt, we make no finding that Sky holds a dominant position on any relevant market.

remedy does not define the risk. On the contrary, the remedy can only be defined once the risk has been identified. The question whether a short-run remedy would be appropriate is a matter of design for consideration, in the first instance, by the CMA.

121. Thirdly, BT contests the suggestion that Ofcom could rely upon the mere threat of a price squeeze to satisfy the threshold question. We have serious doubts that the mere threat of a price squeeze, whilst undoubtedly a potential source of market distortion, can be regarded as conduct which, standing alone, constitutes the imposition of a price squeeze. We recognise that both the 2014 VULA Margin Consultation (at paragraph 3.59) and Mr Matthew's witness statement refer to a threat as a self-standing concern. However, that is not how we read Ofcom's treatment of that issue in its Statement. Rather, it treats the fact of a price squeeze as an implicit threat that, absent regulation, the conduct will be renewed: see Statement paragraphs 3.90 and 3.91. Viewed in that way, we consider that to be a perfectly correct approach to assessing the potential impact of a price squeeze and one that falls squarely within the provisions of the legislation. In any event, this is an ancillary point which does not impugn the remainder of Ofcom's analysis.

122. For the reasons stated above, we conclude that the possible pricing strategy identified by Ofcom as the basis for the SMP condition, namely a strategy preventing an operator with slightly higher costs than BT (or some other slight commercial drawback relative to BT) from being able profitably to match BT's retail SFBB offers, may legitimately be considered to be a price squeeze for the purpose of section 88.

Proposition (iii): Tribunal's assessment of foreseeability of price distortion

123. This part considers BT's arguments as to the foreseeability of adverse effects on end users resulting from a price squeeze that Ofcom is required to demonstrate.

124. Section 88 expressly requires that Ofcom identify a "relevant risk of adverse effects arising from price distortion", that is to say that BT "might so impose a price squeeze as to have adverse consequences for end–users of public electronic communication services." More straightforwardly, we understand the question to be: "might BT impose a price squeeze that would have adverse consequences for end-users?"

125. BT submits that "might" should be read as "likely" so that there is only a relevant risk of price distortion if it is likely that BT would charge a price that would have the requisite adverse consequences.

126. Without suggesting any degree of mathematical precision (which would, in any event, be implausible) it is plain to us that, in ordinary usage, a stronger degree of belief or expectation attaches to an event that is "likely" to occur than to one that "may" or "might" occur or that has a "risk" of occurring.

127. The assimilation of "risk" to "likelihood" in the Article 102 jurisprudence (noted in paragraph 78 above) does not, in our view, assist: those cases reflect the judicial evolution of a Treaty provision that contains no specification for any probability standard at all. By contrast, in the present case, there is an express calibration of the concept of risk which, in our view, should be given its natural and ordinary meaning.

128. More fundamentally, an Article 102 assessment differs from the present assessment in that it addresses the legality of a particular course of conduct. In that case, the decision-maker is required to determine whether, having regard to all the circumstances, it is probable that that course of conduct will have the requisite exclusionary effect. In the present case it is, in our view, sufficient for Ofcom to demonstrate that, within the spectrum of pricing strategies that BT might realistically be expected to adopt, there are instances that constitute a price distortion.

129. As noted above, BT emphasises the need for great care in a prospective analysis. Mr Thompson relied in particular on the judgment of the CJEU in *Tetra Laval* 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 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."

130. Although the context of that case was different (concerning a conglomerate merger), he maintained that the requirement for careful analysis is one that applies to any prospective analysis. In that respect, he drew attention to the Commission's Non-horizontal Merger Guidelines which consider, in a merger context, essentially the same analytical issues of vertical foreclosure as arise here: see, in particular, paragraphs 40ff.

131. We do not consider that these materials throw any useful light on the approach that, as a matter of common sense, should be adopted by Ofcom or applied by the Tribunal in reviewing Ofcom's decision. It is indisputable that Ofcom must satisfy themselves, to the requisite standard, as to the statutory questions posed in section 88. That requires a careful analysis of all the circumstances, taking into account the foreseeability that a future effect may occur. The weight of evidence and analysis required in a particular case must take account of the fact that, as Lord Hoffmann observed in *Secretary of State for Home Department v Rehman* [2001] UKHL 47 at [55], "some things are inherently more likely than others": the CJEU's judgment in *Tetra Laval*, quoted above, makes the same point.

132. With particular reference to the assessment of a price squeeze, the need to take due account – at an appropriate stage of the analysis - of the deterrent effect of Article 102 is not disputed and, indeed, is built into the *Hutchison 3G (CAT)* assessment that Ofcom applied. As for the Non-horizontal Merger Guidelines, they can do no more than their title suggests, namely to provide guidance as to the analytical structure that may be adopted: they do not provide a prescriptive statement of the approach to be adopted by Ofcom. In both instances, the question for decision is whether Ofcom has adequately carried out the respective assessments – which is a matter that we consider in the following parts.

Tribunal conclusion

133. For these reasons, we conclude that BT has not shown that Ofcom erred in its approach to the assessment of relevant risk of adverse effects arising from a price distortion.

5(B) Did Ofcom err in law by failing to take account in its market analysis of legal and regulatory constraints affecting BT?

Introduction

134. In this part we consider whether, as BT alleges, Ofcom has erred in law by excluding from consideration as part of its market analysis in Section 3 of the Statement: (i) the deterrent effect of *ex post* competition law; (ii) obligations imposed on BT in 2014 to supply VULA on 'fair, reasonable and non-discriminatory terms' ("FRAND"); and (iii) the undertakings in lieu of a reference to the Competition Commission accepted from BT by Ofcom under the Enterprise Act 2002. We first set out some relevant background on the two regulatory constraints in issue.

The FRAND Obligation

135. Ofcom's 2010 Statement was the first review in which Ofcom actively considered how to regulate VULA access. The remedies imposed by Ofcom in relation to VULA were set out in SMP conditions FAA11.1, FAA11.2 and FAA11.3, requiring BT to provide VULA wherever third parties reasonably required it on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom might from time to time direct and on a non-discriminatory, equivalence of inputs basis (the "FRAND Obligation"). The 2010 Statement made it clear that Condition FAA11.2 was intended to prevent BT from pricing VULA services in a way that could result in price squeezing: 2010 Statement, paragraph 8.129.

136. The 2010 Statement set out some high level principles about how the VULA margin should be assessed, but these did not constitute detailed guidance.

137. In the 2013 FAMR Consultation, Ofcom originally proposed adopting a similar course, but to supplement the FRAND Obligation with guidance as to how Ofcom would be likely to undertake its assessment when testing whether the VULA margin complied with that obligation. Such guidance could either accompany the FRAND Obligation or be in the form of in a separate SMP condition imposing a specific control on the VULA margin, or a combination of the two.

138. On 26 June 2014, Ofcom published the 2014 FAMR Statement which addressed all FAMR issues other than the VULA margin. It imposed conditions on BT which included a FRAND Obligation in respect of the supply of VULA.

139. In the 2014 VULA Margin Consultation, Ofcom consulted on a set of proposals for regulating the margin between BT's wholesale VULA and retail SFBB prices. Ultimately this consultation resulted in the publication of the Statement under consideration and the imposition, pursuant to that Statement, of a price control in respect of the VULA margin.

The BT Undertakings

140. Following Ofcom's *Telecommunications Strategic Review* in 2005, BT offered and Ofcom accepted undertakings in lieu of a reference to the Competition Commission under the Enterprise Act 2002 ("the BT Undertakings"). Central to the BT Undertakings was the establishment of a new, functionally separate, division of BT which became Openreach.

141. The consultation on the BT Undertakings issued on 30 June 2005 stated (at paragraph 5.15) that the proposed undertakings were intended to address discriminatory conduct, including changes in the margin between an upstream and downstream product which could affect competitors' ability to compete in each of these markets and (at paragraph 5.28) to alter the incentives of BT to engage in discriminatory practices.

142. The BT Undertakings include a requirement that Openreach offers its services to BT Consumer and to all of its other CP customers on the basis of 'equivalence of inputs', i.e. on the same timescales, terms and conditions, by means of the same systems and processes, and with the same provision of confidential information and same provision of information terms, conditions and prices.

Arguments of the parties

143. Section 3 of the Statement includes the market analysis which Ofcom is required to carry out for the purpose of setting an SMP condition in accordance with section 88(1) of the 2003 Act. Ofcom explicitly excluded from the market analysis the impact of existing legal and regulatory constraints, namely: (i) the deterrent effect of *ex post* competition law; and (ii) the FRAND Obligation; Statement, paragraphs 3.59 and 3.78. Ofcom chose not to take account of these constraints at that stage of the analysis on the basis that this was the appropriate counterfactual following the modified Greenfield

approach as explained by the Court of Appeal in *Hutchison 3G v Ofcom* ([2009] EWCA Civ 683) (*"Hutchison 3G (CA)")*.

144. BT contends that Ofcom's disregard of the effect of existing legal and regulatory constraints (including the BT Undertakings) in its market analysis in Section 3 of the Statement is based on a misreading of *Hutchison 3G (CA)*, that Ofcom's market analysis is consequently defective and that Ofcom is therefore precluded from setting a price control.

145. Ofcom disputes these contentions but argues, in the alternative, that even if, contrary to its primary position, it was wrong not to take into account existing constraints in Section 3, the point is academic because in Section 4 of the Statement it considered whether the regulatory aim of addressing the risk of a price distortion would be sufficiently addressed by other forms of regulation, including, in particular, the FRAND Obligation or *ex post* competition law, and concluded that it would not. Ofcom also maintains that it was not necessary to consider the BT Undertakings in either Section 3 or 4 of the Statement because these do not address the risk of a price squeeze.

Tribunal's assessment

146. The term "modified Greenfield" is not a statutory term or term of art. As explained by the European Commission in the *RegTP* decision (DE/2005/0144), extensively quoted by the Court of Appeal in *Hutchison 3G (CA)*, it denotes a hypothetical scenario used for the purpose of an assessment of SMP, in which regulatory constraints existing independently of an SMP finding on the market in question are taken into account, whereas regulatory constraints which are dependent on an SMP finding are ignored in order to avoid circularity. If they were taken into account, a market might be found to be effectively competitive and the constraints removed, returning the market to a situation which would no longer be competitive. Lloyd LJ commented on the scope and purpose of the modified Greenfield approach in *Hutchison 3G (CA)* as follows:

> "53 As the Commission said in paragraph (23) of the RegTP decision, the point of the modified Greenfield approach is to avoid circularity in relation to a market assessment as regards SMP. SMP is not to be found to be absent from a market if its absence is the result of regulation which is in place. Correspondingly, looking forward, an undertaking which would otherwise have SMP is not to be entitled to argue that it does not have it because its freedom of operation is or would be limited (directly or indirectly) by regulatory provisions such as are designed to be put in place in order to constrain the exercise of SMP. Whether a market is "effectively competitive" must be assessed regardless of the regulatory constraints that might be imposed if it is found that it is not. Otherwise the regulatory regime would in this respect be self-defeating."

147. The judgment of the Court of Appeal in *Hutchison 3G (CA)* does not address the issue arising in this case, namely whether or not a section 88 market analysis should take into account existing regulatory constraints affecting the market. Moreover, the reasoning of the Court of Appeal in holding that the regulatory constraints in issue in *Hutchison 3G (CA)* were to be ignored on an assessment of SMP, namely that the regulatory structure would otherwise be subverted, is not relevant to the present case: there is no suggestion by either party that taking into account existing legal and regulatory constraints in Ofcom's market analysis would subvert the regulatory structure. It therefore follows, in our view, that the Court of Appeal's decision in *Hutchison 3G (CA)* does not require Ofcom to take as its counterfactual a market without existing regulatory constraints.

148. The question then arises whether Ofcom erred in carrying out its market analysis on this basis. In the absence of specific statutory or judicial direction, it is Ofcom's task to adopt an appropriate approach to its analysis with which the Tribunal should not interfere unless satisfied that it is wrong in principle or in its application.

149. We consider that Ofcom was entitled to undertake its market analysis in the way that it has done. It was appropriate for Ofcom to analyse the market in the absence of the FRAND Obligation and then to ask, as it did in Section 4, whether the FRAND Obligation was sufficient to address the identified risk of a price squeeze. It was also appropriate, in our view, for Ofcom to take into account the deterrent effect of *ex post* competition law in Section 4, in

conjunction with its consideration of the FRAND Obligation, rather than considering *ex post* competition law separately in the market analysis.

150. In our view, Ofcom's approach was both reasonable and logical. It is, moreover, consistent with the approach that the Tribunal adopted to the treatment of regulatory constraints in *Hutchison 3G (CAT)* at [287]. Ofcom considered in Section 3 whether any *market factors* remove the risk of a price distortion. One can reasonably take the view that legal and regulatory constraints of the type in issue here are not market factors. Instead they are measures that are within Ofcom's control: Ofcom could decide to take action using its *ex post* competition powers; it might, in addition or alternatively decide to impose (or maintain) a FRAND obligation. Those options may reasonably be considered within the context of remedies. They are part of the potential solution, not the problem.

151. If, contrary to our view, Ofcom was wrong to take as its counterfactual in Section 3 the market in the absence of regulatory and legal constraints, the question arises if this approach vitiated its conclusion as to the risk of a price distortion and the need for regulation of the VULA margin and requires that conclusion to be set aside.

152. Under section 195(2) of the 2003 Act, the Tribunal's task is to decide on the merits whether Ofcom's determination is wrong. The Tribunal is not constrained by the precise reasoning in the decision under appeal and it therefore does not follow that if there is an error in the reasoning that the decision must be quashed or the appeal allowed. BT must show that the decision is so undermined by the error that it cannot stand; see *Everything Everywhere Ltd v Competition Commission* [2013] EWCA Civ 154 at [24].

153. In order for BT to succeed with this element of its appeal, it would therefore not be enough for it to show that Ofcom erred in taking account of existing regulatory constraints in Section 4 rather than Section 3 of the Statement. It would have to show that, had Ofcom taken account of these constraints in Section 3 rather than Section 4, this would have affected its conclusion.

154. Ofcom contends that its consideration of regulatory constraints in Section 4 rather than Section 3 of the Statement does not make any material difference to its decision on the risk of a price distortion. This is on the basis that, having concluded, based on its market analysis in Section 3, that there was a risk of adverse effects arising from a price distortion, and having defined its regulatory aim as being to address this risk, Ofcom proceeded to ask in Section 4 of the Statement whether that aim was addressed by other forms of regulation. It concluded that neither the FRAND Obligation nor *ex post* competition law would achieve this aim: Statement, paragraphs 4.15-4.23. Ofcom contends that a decision that regulatory and legal constraints would not adequately address the risk of adverse effects arising from a price distortion is logically indistinguishable from a decision that, having taken into account such constraints, there is a risk of adverse effects occurring.

155. BT's response to this contention is that Ofcom's treatment of regulatory constraints in Section 4 rather than Section 3 does make a fundamental difference for the following reasons. First, the existence of regulatory constraints should have been taken into account for the purpose of assessing whether there is a realistic likelihood of consumer harm arising from a price squeeze. Second, the Section 4 analysis incorporates considerations of appropriateness of design, e.g. as to whether different regulatory options would provide sufficient certainty to BT and other CPs, which are not relevant to an analysis of "relevant risk of adverse effects" under section 88(1)(a). Third, Ofcom's approach to the *elimination* of risk in Section 4 applies a standard inappropriate to the analysis of prospective risk required under section 88(1)(a). In Section 4, Ofcom sets as its "*regulatory aim*" to "*remove*" the risk identified in Section 3 and thus to ensure that BT "*cannot*" impose a price squeeze; under section 88(1)(a), Ofcom cannot intervene unless the risk is "*significant and real*". In quantitative terms, if the relevant Section 3 test of "*significant and real*" risk were set as a risk of more than 40%, then an assessment of alternative constraints by reference to a test of *removal* or *elimination* of such risk, i.e. reducing the risk to (or at least close to) 0%, would apply too stringent a test.

156. It seems to us that Ofcom's assessment of the effects of the FRAND Obligation and the deterrent effects of *ex post* competition law in Section 4 could reasonably have been incorporated in Section 3 of the Statement, in the part headed "Are there any factors which remove this risk?" without making a material difference to the conclusions in that section, or to the Statement overall. The matters considered as part of this assessment, such as lack of certainty, are not purely design issues but are also relevant to the risk of BT engaging in a price squeeze to the detriment of end-users. Given Ofcom's conclusions in Section 4 as to the insufficiency of the FRAND Obligation and *ex post* competition law in addressing the aim of ensuring that BT did not engage in a price distortion, Ofcom would no doubt have concluded that those constraints (separately or together) did not remove the risk of a price distortion if they had been considered in Section 3. Ofcom's overall conclusion in Section 3 as to the existence of the risk of a price distortion would have been unaffected.

157. The dichotomy which BT seeks to create between Section 3 and Section 4 in terms of different percentage risks is, in our view, both artificial and incorrect. In Section 3, Ofcom considers if there are *market factors* that *remove* the risk of a price distortion. BT has not taken issue with approach. Considering legal and regulatory constraints in Section 3 would similarly involve an assessment of whether or not those constraints remove the risk of a price distortion. We therefore do not accept BT's submission that Ofcom might well have reached a different conclusion had it considered the legal and regulatory constraints in the context of its market analysis in Section 3 rather than in Section 4.

Tribunal conclusion – Approach to assessment of legal and regulatory constraints

158. We conclude that Ofcom was entitled to take as its counterfactual for the purposes of its market analysis in Section 3 of the Statement the market in the absence of existing legal and regulatory constraints. If, contrary to this view, Ofcom ought to have taken account of these matters in its market analysis in

Section 3, this would not have made any material difference to its conclusion as to the risk of a price distortion.

5(C) Did Ofcom fail to give sufficient weight to existing legal and regulatory constraints?

159. We consider below whether, as BT alleges, Ofcom is wrong to consider that additional regulation is required beyond the existing legal and regulatory constraints namely: (i) the FRAND Obligation (see also paragraphs 135-139 above); (ii) the BT Undertakings (see also paragraphs 140-142); and/or (iii) *ex post* competition law.

The FRAND Obligation

160. BT draws attention to the fact that the 2010 Statement explicitly acknowledged that the FRAND Obligation was designed to prevent BT from engaging in a price squeeze and to the fact that no CP had ever submitted a complaint to Ofcom under this "fair and reasonable" remedy about the level of the VULA margin. BT submits that Ofcom fails to give sufficient weight to the FRAND Obligation in deciding that further regulation of the VULA margin is required.

161. Ofcom's position, as set out in the Statement itself (paragraphs 4.62 - 4.72) and supported by Mr Clarkson's evidence, is that the period 2014 – 2017 is likely to be important in the development of the broadband market and that it is appropriate to include greater detail in a separate SMP condition rather than in guidance accompanying the FRAND Obligation. In particular, Ofcom considers that inclusion of certain parameters in the SMP condition concerning cost adjustments that BT must follow will limit the scope for ambiguity around what BT is required to do and provides a reasonable degree of certainty over the margin it needs to maintain. This addresses the drawback of a purely guidance-based approach under which BT would not have information on the required cost adjustments, making it difficult for BT to comply with the regulation. It also limits the opportunities for gaming and

disputes. Ofcom points out that the lack of certainty inherent in the FRAND Obligation supplemented with guidance would prejudice other CPs in judging BT's compliance and the level of the VULA margin and therefore whether they can profitably match BT's prices. This would in turn affect their decision to invest in winning SFBB subscribers. An SMP condition will allow appropriate flexibility to accommodate significant future changes in the market.

162. BT's witness, Mr Tickel, accepted in his witness statement and in cross examination that Ofcom's guidance accompanying the FRAND Obligation was not particularly detailed:

> Q. You note that Ofcom did not set out extensive guidance on how a price squeeze was to be assessed when setting the FRAND condition. That is at paragraph 78 of your statement.
>
> A. That is correct.
>
> Q. And the fair and reasonable test is very open-ended, isn't it?
>
> A. I don't know what you mean by "open-ended"; I think it's --
>
> Q. It doesn't supply details about how a margin squeeze test would be applied in practice.
>
> A. No, but it's typical of many, many regulatory rules we face and have faced over the years. Not to unduly discriminate, not to implement unfair cross-subsidies are just some of the remedies that have been in place, with the focus being, well, if there is a reason to believe you may have breached it, we will look at the detail at the time and see what the effects of the complained-of behaviour actually are.[22]

163. Ofcom points out that the lack of certainty in the FRAND Obligation is illustrated by the disagreement between the parties' witnesses[23] as to whether the FRAND Obligation incorporated an effects analysis and the disagreement between BT and Ofcom as to the appropriate test for a price distortion, as illustrated by BT's challenge to the design of the margin condition in the proceedings now before the CMA.

164. We consider that Ofcom's evidence is persuasive and are of the view that Ofcom was entitled to conclude that the FRAND Obligation would not

[22] Transcript Day 2, pages 49 – 50.
[23] Transcript Day 2, page 50, lines 1 – 9; Day 3, page 39, lines 3 – 11.

effectively address the risk of an appreciable price distortion because it would leave too much uncertainty for BT and for other CPs in judging BT's compliance with the FRAND Obligation which would, in turn, affect their investment decisions. Moreover, the debate before us on the meaning of a section 88 price distortion and the applicability of the Article 102 jurisprudence in that context suggests to us that there is likely to be a high degree of uncertainty over what might be considered permissible under the FRAND Obligation.

The BT Undertakings

165. As noted above, central to the BT Undertakings was the establishment of a new, functionally separate, division of BT which became Openreach. The consultation on the BT Undertakings issued on 30 June 2005 stated (at paragraph 5.15) that the proposed undertakings were intended to address discriminatory conduct, including changes in the margin between an upstream and downstream product which could affect competitors' ability to compete in each of these markets and (at paragraph 5.28) to alter the incentives of BT to engage in discriminatory practices.

166. The BT Undertakings include a requirement that Openreach offers its services to BT Consumer and to all of its other CP customers on the basis of 'equivalence of inputs', i.e. on the same timescales, terms and conditions, by means of the same systems and processes, and with the same provision of confidential information and same provision of information terms, conditions and prices.

167. BT drew attention to the requirement in the BT Undertakings for the functional separation of Openreach and other BT divisions, including measures such as separate remuneration systems and bonus arrangements for employees of Openreach, a separate management board and separate reporting lines for Openreach's CEO to the CEO of BT Group. BT notes that there are also requirements that no employee or agent of BT who is not working for Openreach shall directly or indirectly participate in the formulation or making

of Openreach's commercial policy or have access to Openreach's commercial information.

168. Mr Petter's evidence (for BT) is that because of: (i) the functional separation between Openreach and the other BT divisions required under the BT Undertakings; (ii) the requirement under the BT Undertakings for Openreach to sell its services on an 'equivalence of inputs' basis; and (iii) the regulatory obligations imposed by Ofcom on BT such as the requirement not to unduly discriminate between its CP customers, BT is not able to exploit its position in the vertically integrated BT in the way that other vertically integrated companies can. He also explains how the employees of BT's retail arm, BT Consumer, are incentivised on the basis of the performance of BT Consumer and that BT Consumer and its employees have no incentive to engage in a margin squeeze strategy as this would cut across their commercial objectives and BT Consumer's financial incentives. Moreover, a pricing strategy which effectively transferred profitability from BT Consumer to Openreach would have a negative impact on BT's share price, because City analysts attach greater weight to BT Consumer's profits than Openreach's. He also states that a price distortion strategy would be very obvious to anyone reviewing BT's published financial reports.

169. BT submits that the BT Undertakings should have been taken into account by Ofcom in the assessment of BT's incentives to implement a price distortion and that if they had been taken into account, there would have been no need for additional regulation to address the risk of a price distortion. BT argues that the Undertakings are directed at the elimination of discrimination, that discrimination is an important element in the assessment of risk of consumer harm arising from a price squeeze and that the BT Undertakings were adopted in part to address wider concerns over BT engaging in an abusive margin squeeze and were intended to alter BT's incentives to engage in such conduct.

170. Ofcom accepts that the BT Undertakings and their incentive effects were not considered in the Statement but it contends that it had not been necessary to do so as the BT Undertakings are not concerned with the risk of a price distortion.

With regard to the equivalence of input obligations, Ofcom submits that these would not preclude a price distortion of the paradigm type that the VULA margin condition is intended to avoid. Ofcom's central concern is not that Openreach will charge higher prices to other CPs than to BT Consumer but that Openreach will charge the same wholesale price to those CPs as to its own retail divisions and the difference between the wholesale price and BT Consumer's SFBB retail prices (which are unaffected by the equivalence of input obligations) will give rise to a relevant risk of a price distortion.

171. With regard to functional separation, Ofcom accepts that this is potentially significant but contends that a number of the undertakings, including paragraph 20.9 highlighted by Mr Tickel ("*…the nominated individuals (if any) and individuals occupying the roles and functional areas set out in Annex 2 shall not abuse their positions to circumvent the intent of these Undertakings*"), are extremely general and vague and in any event not intended to address the risk of a price distortion. It also notes that the undertaking in paragraph 5.38 not to participate in the formulation or making of Openreach's commercial strategy does not apply to a range of senior BT executives who may take a strategic view of BT's business as a whole. Ofcom also draws attention to the reference in Mr Petter's witness statement to BT deciding to prioritise its sale of retail fibre broadband in order to make its enormous investment commercially viable "*taking a group perspective*" and his acceptance in cross-examination of the fact that that the commercial policy in relation to BT Consumer's activities was set centrally. Ofcom also points to the fact that when the undertakings were introduced, Ofcom made clear that any concern with margins would need to be addressed separately through the *ex ante* framework. Finally, Ofcom draws attention to the fact that paragraph 5.41.1 exempts from the BT Undertakings a long list of people including, among others, any member of a committee of the board of BT Group.

172. It is not evident to us that BT relied on the BT Undertakings at the time of the 2014 VULA Margin Consultation in support of its case that no further regulation of the VULA margin was appropriate, which may explain why they are not addressed in the Statement.

173. In any event, in light of the equivalence of inputs obligation, we find Ofcom's position that the Undertakings are predominantly focused on preventing discrimination compelling. Ofcom was, in our view, entitled to conclude that the Undertakings are insufficiently targeted at the risk of a price distortion and not designed or drafted in such a way as to impede BT's ability to implement such a pricing strategy. BT has not persuaded us that Ofcom has erred in this regard.

Ex post competition law

174. BT contends that it is sufficiently constrained by the "very substantial deterrent penalties which could be imposed" if BT were found to have engaged in a margin squeeze in breach of Article 102 TFEU; this removes any relevant risk of a price distortion and Ofcom was wrong to ignore the constraints of competition law in its assessment.

175. Ofcom submits that *ex post* competition law would not be effective in achieving its regulatory aim. It notes that the CRF recognises that *ex post* competition law has proved insufficient in circumstances where firms have enduring market power and submits that *ex post* competition law would be insufficient to address the risk of a price distortion in the present case for the following four reasons.

176. First, *ex post* competition law is unable to prevent competitive distortions as it is necessarily after the event. Second, an *ex post* approach may result in a significant time lag between any abuse and its identification and punishment. Third, BT might pass an *ex post* competition law test even though its margin was insufficient to avoid competitive distortions, because *ex post* competition law does not, except in particular circumstances, allow the use of an adjusted EEO approach. Fourth, Ofcom is concerned to ensure that there is sufficient certainty as to how it would assess the acceptable level of margin.

177. BT's response to these arguments is, in short, first, that BT is under close scrutiny both by Ofcom and its commercial rivals and that allegations of infringement could be acted on quickly, including through the imposition of interim measures. Second, in treating *ex post* competition law as simply a matter of regulation "after the event", Ofcom has ignored the important deterrent impact of EU and UK enforcement activity as a highly material factor to consider in any assessment of BT's incentives to engage in a strategy of excluding competitors from the broadband market by a margin squeeze during the current market review period. Third, the case law of the CJEU and the administrative practice of the European Commission and Ofcom now provide an undertaking in the position of BT with detailed guidance as to the applicable legal and economic principles so that market operators have the necessary degree of certainty as to the parameters of acceptable market conduct. Fourth, historic evidence of BT's conduct provides no support for a concern that BT is likely to engage in an abusive margin squeeze.

178. Ofcom submits that, notwithstanding the deterrent effects of *ex post* regulation, operators with SMP do sometimes breach competition law, that any competition law investigation into VULA/SFBB prices would be complex and time consuming and that, in the present market context, even a short delay might have a significant impact on the development of competition.

179. *Ex post* competition law would be likely to give rise to uncertainties regarding whether adjustments would be made to BT's costs and what level of VULA margin should be set to ensure compliance. It is not an answer to the need for certainty that a number of competition investigations now provide a measure of certainty as to the parameters of acceptable market conduct as they do not address the detail of the adjustments to be made to BT's costs or the need for a detailed assessment of the potential effects of a price squeeze. *Ex post* competition law would require Ofcom to establish at least the potential for anti-competitive effects in the downstream market as a consequence of BT's failure to maintain a sufficient margin, which would add to the time and complexity of the proceedings.

180. Ofcom also refers to a concern raised by TalkTalk that BT might pass an *ex post* competition law test even though its margin was insufficient to avoid competitive distortions. It notes that *ex post* competition law does not, except in particular circumstances, allow the use of an adjusted EEO approach; the general approach to assessing margin squeeze is to consider the costs of the dominant undertaking itself, not the costs of its competitors: see *TeliaSonera Sverige*. Further, according to the Commission's G the benchmark generally relied on in *ex post* competition law to determine the costs of an equally efficient competitor is the LRIC of the downstream division of the integrated dominant undertaking rather than LRIC+.

181. BT also submits that Ofcom failed to give proper weight to the numerous investigations that Ofcom has conducted into margin squeeze allegations that have been made against BT over the years, in particular the Competition Act investigation into a complaint by TalkTalk that BT had engaged in a margin squeeze in respect of its supply of SFBB and its supplemental complaint that the pre-existing margin squeeze had been exacerbated by BT's decision to offer BT Sport free of charge to existing BT broadband customers, following which Ofcom decided that there were no grounds for action. Ofcom's response is that the Competition Act investigation was not directed at the test imposed by the VULA margin condition, in particular Ofcom used an EEO approach to BT's costs, not an adjusted EEO, and applied a LRIC cost standard. Further and in any event, historical conduct is at most of marginal relevance to the question of future risk.

182. We consider that Ofcom has not erred in the way it took account of the constraints of *ex post* competition law acting on BT. The reasons set out in the Statement (paragraphs 4.15 to 4.22) are compelling. We note in particular that the CRF clearly envisages situations where *ex post* competition law is insufficient to address the risk of the implementation of a price distortion by a company that has been found to have SMP. Moreover, in light of our conclusions in part 5A of this judgment, we agree with Ofcom and TalkTalk that there may be situations where BT might pass an *ex post* competition law test even though its margin is insufficient to avoid a price distortion within the

meaning of section 88. Even if that were not the case, there is likely to be some uncertainty surrounding the appropriate benchmark for assessing whether BT's pricing is abusive within the meaning of Article 102. More generally, any uncertainty and delay surrounding enforcement is likely to negatively affect the investment incentives of BT's competitors in SFBB.

Tribunal conclusion – Weight accorded to existing legal and regulatory constraints

183. For the reasons set out above we consider that Ofcom gave proper weight to the FRAND Obligation and to the deterrent effects of *ex post* competition law in concluding that further regulation of the VULA margin was required. In our judgement, Ofcom was entitled to conclude that the BT Undertakings did not address the risk of a price distortion and did not need to be specifically considered in its market analysis because they may reasonably be considered to be largely irrelevant in the context of addressing the concerns that Ofcom had identified and was seeking to address in the Statement.

5(D) Was Ofcom wrong to consider that any additional regulation was required beyond existing regulation?

184. BT submits that any suggestion to impose a VULA margin control should have been rejected *in limine* by Ofcom for the following reasons. First, there was no evidence that the existing regulation pursuant to the 2014 FAMR Statement had proved inadequate to protect effective retail competition in the broadband market. Second, the nature of the market, increasingly characterised by differentiated bundling by four major retail competitors with a distinct balance of advantages and commercial strategies, would render any exclusionary strategy based on margin squeeze for only one upstream input very difficult to implement. Third, there is no evidence that BT is intending to engage in such a strategy. Fourth, there is no evidence that BT has in practice implemented an exclusionary strategy or that it has set prices at such a low level as to raise a presumption of abusive pricing. Fifth, there are significant regulatory risks associated with implementing the proposed condition.

185. We consider that Ofcom was entitled to conclude, in the exercise of its regulatory judgement, that additional regulation was required beyond the regulation existing under 2014 FAMR Statement. It is clear that, as a matter of law, it is not necessary for Ofcom to demonstrate that BT has engaged in or attempted to engage in a price distortion: see *Hutchison 3G (CAT)* at [296]. We agree with Ofcom that an absence of evidence of current intent on BT's part to engage in a margin squeeze is of limited relevance to the risk of a margin squeeze in the future. Ofcom's treatment of BT's past conduct, the competitive advantages of BT's competitors and the risks of regulatory intervention, which we consider in part 5(E) below, were properly taken into account by Ofcom. Ofcom was entitled to conclude that these factors did not remove the need for the VULA margin condition.

5(E) Did Ofcom fail to analyse the prevailing market conditions to the requisite standard?

186. BT submits that Ofcom's market analysis cannot withstand 'profound and rigorous scrutiny': there is a substantial onus on Ofcom to demonstrate that there is a 'realistic likelihood' of BT engaging in a price distortion. There are a number of elements to this aspect of BT's Ground 1, which we set out in the next paragraph. However, by way of preliminary observation, we note that we do not agree with BT that Ofcom must demonstrate that there is *realistic likelihood* of BT engaging in a price distortion; it is sufficient, for the purpose of sections 88(1)(a) and 88(3) that Ofcom is able to show that BT *may* engage in a price distortion: see the reasoning and conclusions in part 5A of this judgment.

187. The errors alleged by BT under this aspect of Ground 1 are as follows:

a. Ofcom has made errors in the assessment of BT's incentives to engage in a price distortion;

b. Ofcom has erred in placing undue reliance on market shares and in failing to investigate sufficiently the following competitive constraints that impact on BT's incentives:
    i. BT's rivals;
    ii. standard broadband;
    iii. the potential for competitors to build their own fibre networks;
    iv. the threat of re-entry by rivals;
c. Ofcom has also erred in not taking proper account of:
    i. BT's past conduct;
    ii. the risks of regulation; and
d. Ofcom ought to have carried out a quantitative analysis of BT's incentives.

188. Before dealing with each of these, we note that in the course of the hearing it became clear that there was little or no dispute about BT's ability to impose a price squeeze in light of the fact that it possesses significant market power in the upstream market.[24]

BT's incentives to implement a price distortion

189. BT disagrees with Ofcom's assertion that, in the absence of regulation, there is a relevant risk that BT has an incentive to impose a price distortion. According to Ofcom, the incentives for BT to behave in this way are as follows:

(i) raising the VULA price will raise BT's rivals' costs in supplying SFBB; if BT does not raise its own retail price then its retail businesses can win a larger share of downstream sales;

(ii) by imposing a margin squeeze, BT undermines the incentives of other CPs to invest and compete with BT;

[24] Transcript Day 2, page 65 lines 5-9.

(iii) by building up a sufficiently large retail base, BT adversely affects the costs of its competitors and their ability to innovate; and

(iv) by engaging in this behaviour BT could therefore potentially build a strong retail market position which could endure into the long term, weakening the competitive constraint it faces from other CPs in the future. This risk is made worse by the transition from SBB to SFBB increasing dependence of CPs on VULA.

190. BT submits that such a strategy is unlikely in a highly competitive retail market, given its low probability of success and its high cost for BT if the effect is to enhance the position of Virgin Media or leave Sky in the field and possibly provoke a regulatory response from Ofcom.

191. Mr Bishop, BT's expert witness, asserts that if BT's rivals are marginalised from the downstream retail market, then the volume of wholesale supply of VULA that BT will make will decline. In other words, there are costs associated with worsening the terms of VULA, consisting of the likely loss of wholesale revenues, which would need to be taken into account in a full analysis of BT's incentives as well as the extent of the likely increased retail revenues.

192. Mr Bishop goes on to argue that in order to consider the effects of a price squeeze on the profits of Openreach and BT Consumer, it is necessary to assess the likely responses of consumers to such pricing behaviour. Even if one were to assume that the response of BT's VULA-based downstream rivals to an increase in the VULA fee were to be an increase in the retail prices of those bundles which included SFBB, this does not necessarily benefit BT Group as a whole. According to Mr Bishop, a detailed assessment of the question would involve having regard to consumer choice patterns; this is absent from Ofcom's Statement.

193. Mr Bishop describes five possible responses of the end consumers of BT's rivals' SFBB services to an increase in their retail prices as a consequence of a

rise in the VULA price. The consumers of BT's rivals could: (a) switch to BT's SFBB service; (b) remain with the rival and pay the higher price; (c) purchase SBB instead; (d) purchase SFBB from Virgin Media or another provider with its own network; or (e) not purchase broadband.

194. In his cross-examination of Mr Bishop, Mr Holmes produced a table detailing the impact on Openreach, BT Consumer and the overall impact on BT Group of these five possible consumer responses. The table recorded that the net impact of (a) and (b) would be to increase BT Group's profits because both would raise Openreach's revenue without reducing BT Consumer's revenue. In contrast, (c), (d) and (e) would result in a BT Group net loss because there would be no impact on BT Consumer and a loss of revenue for Openreach in each case.

195. A separate possibility was also considered in the table of BT's rivals absorbing the VULA price increase in lower profit margins and leaving their retail prices unchanged, in which case there would be a net gain to BT Group because Openreach's profits would increase while BT Consumer's would be unchanged.

196. BT subsequently produced a second table elaborating on Mr Holmes's table by considering an alternative way in which a price distortion could be achieved by lowering BT Consumer's price, causing BT Consumer to earn negative margins on new customers. BT suggested that the effect of this on BT Consumer's profits was negative if consumers switched to BT from its rivals and zero if they did not and that since Openreach's profits were unaffected, the overall impact on BT Group profits was either zero or negative.

197. It was further suggested by BT that a price squeeze that reduced the proportion of BT's profits coming from BT Consumer relative to Openreach would have a particularly detrimental effect on BT's valuation because investors attach a higher multiple to its Consumer than its Openreach profits. According to Mr Petter, city analysts attach a 12-times multiple to the profits of BT Consumer

and a 7-times multiple to the profits of Openreach as a basis for predicting future profitability, on the implicit assumption that profits in Openreach get regulated away over time. In BT's view, the profitability of a price squeeze therefore depends on its form, the possible price response of BT's rival, the purchase decisions of end consumers and the way in which it reallocates profits between Openreach and BT Consumer.

198. In his witness statement for TalkTalk, Mr Heaney states that BT has a particularly strong incentive to impose a price squeeze because the majority of customers switching away from TalkTalk will chose to take a BT product instead. He notes that in tracking the destinations of customers leaving TalkTalk in the first half of 2015, between 33% and 37% switched to BT retail as against 9% to 11% to Virgin Media.

199. Furthermore, Mr Heaney states that once consumers switch to the improved performance provided by SFBB, they are highly unlikely to switch back to standard broadband, as its performance will feel very poor by comparison with what they have become used to. Indeed the spindown from fibre is so low that TalkTalk does not even track customers doing so. He also believes it to be implausible that TalkTalk is in a position to raise prices without losing very substantial numbers of customers. He records that TalkTalk's data are consistent with a high price elasticity of demand for its broadband products, implying that an increase in price would result in a significant loss in demand for TalkTalk. In other words, if TalkTalk were to raise its prices, scenario (a) described at paragraph 193 above is more likely than scenarios (b), (c) or (d), resulting in a probable increase in profits for BT Group from a rise in VULA prices.

200. In our view, while the impact of a price squeeze on BT's overall profits is clearly relevant to the incentive to engage in one, it is not the only consideration. As Ofcom pointed out in cross-examining Mr Bishop, four of the five scenarios of consumers' response to a VULA price increase (namely (a), (c), (d) and (e)) are detrimental to BT's rivals. Ofcom notes in the Statement that this will reduce the incentive of BT's rivals to invest in SFBB

and to compete effectively against BT. The incentives to engage in a price squeeze do not, therefore, merely derive from its short-run impact on BT's profits but also on the long-run incentives and ability of its competitors to compete effectively against BT.

201. The alternative form of a price squeeze to a rise in VULA prices, namely a reduction in BT Consumer's price (paragraph 195 above), does not necessarily involve BT Consumer earning negative margins when a squeeze is judged against a LRIC+ rather than a LRIC standard. If the presence of CPs in the SFBB market requires prices to be in excess of LRIC, then BT can deter competition while still earning positive profits by setting prices between LRIC and LRIC+.

202. Furthermore, in reaction to Mr Petter's observation that the stock market applies a higher multiple to profits in BT Consumer than Openreach, Mr Matthew, for Ofcom, points out that if BT can raise the profitability of BT Consumer by reducing competition in the retail market, in the long-run BT Group shares will go up.

203. We conclude that, while it is difficult to predict the likely response of BT's rivals and their end consumers to a price squeeze, not only does BT have the ability to implement a price distortion but there is a significant risk of it having an incentive to do so in the short-run to raise its profits and in the long-run to discourage its rivals from investing and competing effectively with it. We do not agree with BT that Ofcom's assessment and conclusions are in error in this regard.

204. Mr Bishop asserts that even if one were to assume that BT did have the incentive to engage in such pricing behaviour it would still be necessary to assess whether this would likely lead to adverse effects on consumers (i.e. consumer harm). In particular, he asserts that Ofcom did not consider: (a) competition from Virgin Media; (b) competition from SBB; (c) investment by BT's competitors in their own networks; and (d) the potential re-entry of competitors that are initially forced out by a price distortion. He concludes that

Ofcom's analysis of the likely effects of any pricing behaviour that may give rise to a price distortion is lacking and does not allow the conclusion reached by Ofcom. Moreover, BT contends that Ofcom placed undue reliance on market shares (by which it means BT's share of VULA-based retail SFBB subscribers) given the various constraints mentioned under (a)-(d) above and the fact that the existence of even relatively high market shares on a newly developing market is an imperfect guide to competitiveness of that market. We now turn to a consideration of each of these factors.

Constraints imposed by BT's competitors

205. BT emphasizes the extent to which the ability of BT to impose a price squeeze is constrained by competition in the retail market. It submits that the retail broadband market is highly competitive and characterised by the presence of a vertically integrated competitor, Virgin Media.

206. Mr Bishop argues in his report that BT's rivals enjoy their own competitive advantages which they would be able to use to counter any raise in BT's wholesale price (or decrease in its retail price) and that, because BT's rivals have different competitive advantages, they may decide to compete with BT by emphasising their own competitive advantages. In particular it is suggested that some competitors enjoy certain advantages in relation to TV and that "triple-play" bundles including SFBB, phone lines and pay television exert a constraint on BT.[25] In other words not only is the retail market competitive but competitors also have their own competitive strengths, which allow them to differentiate themselves in competing with BT.

207. BT maintains that Sky's market strength in pay-TV and triple play bundles lends it a particular competitive advantage. According to Mr Petter's evidence, the big winner over the five years that the VULA product has been in existence in terms of broadband market growth has not been BT; it has

[25] "Triple play is becoming increasingly important in the fixed broadband sector, and therefore, going forward, we expect triple play to have a more important role in determining consumer choice." (Mr Bishop, Transcript Day 3, page 16, lines 27-29).

actually been Sky. Sky has grown its broadband base roughly 50 per cent faster than BT. As a consequence, Sky may have a sufficient advantage in pay-TV to remain competitive even in the event of a price squeeze by BT.

208. However, Ofcom draws attention to the fact that: (a) only a minority of consumers purchase "triple play"; (b) a price squeeze may encourage Sky to re-focus its efforts away from bundles including SFBB; (c) raising the VULA price risks dulling competitors' incentives to invest in value-added services; (d) BT has competitive advantages of its own; and (e) competitors such as TalkTalk do not enjoy an advantage in pay-TV. Ofcom therefore argues that the fact that one rival, Sky, has a competitive advantage in pay-TV does not extinguish the risk of a price distortion.

209. TalkTalk contends in its Statement of Intervention that since all the competing retail products are ultimately dependent on VULA inputs, the potential to differentiate does not detract from the consequences of BT imposing a price distortion across the board on all its competitors.

210. Ofcom makes a similar point: the ability of other retailers to compete effectively in the provision of SFBB services in this review period is largely dependent upon access to wholesale inputs from BT, and the only practical way for other CPs to supply SFBB is to purchase VULA from BT. Therefore, VULA is likely to be the key wholesale input for competition in SFBB in this review period. In relation to triple-play, Mr Holmes in his closing submissions for Ofcom stated that only a minority of consumers purchase triple play bundles, and this constraint therefore would not work against a price squeeze in relation to the majority who do not purchase pay television with their broadband. Moreover, in relation to triple play, if a CP's profitability were reduced, this would itself risk reducing competitive pressures on BT in relation to retail offers that include SFBB. The provider would face fewer incentives to invest in SFBB offerings. The final point on triple play is that if a CP did absorb a VULA price increase in this way, then that price increase

would be profitable for BT, potentially increasing its short-run incentives to price squeeze.[26]

211. The one exception in this context is Virgin Media, which uses its own superfast fibre optic network and is not therefore dependent on VULA. However in his witness statement, Mr Matthew for Ofcom notes that Virgin Media's share has been steadily declining since then (2012) while BT's share has been increasing. Virgin Media's share has declined from its peak of 65% in Q3 2012 to 56% in Q1 2014, while BT's share has increased from 31% to 35% over the same period. Virgin Media has limited national coverage and its plans point to an increase in the number of UK premises to which it can provide services by almost a third (approximately an additional four million premises) by 2020, which would still result in sub-national coverage, and which will not be fully realised during the course of this review period. Moreover the presence of only one competitor network is unlikely to be sufficient to engender effective competition. Mr Matthew for Ofcom notes that if competition from VULA based rivals is not forthcoming and BT continues to account for a large share of SFBB sales based on VULA, it is likely that BT would eventually emerge as a substantially larger SFBB retailer than Virgin Media in the future.

212. We agree with Ofcom's conclusions with regard to the constraining effects of BT's competitors and we reject BT's criticisms of this aspect of Ofcom's market analysis. We are of the opinion that competition in the retail market does not mitigate the risk of BT imposing a price distortion because of the dependence of all but one of BT's rivals on VULA and the limited competitive constraint (due to its geographical coverage) imposed by the one significant provider, Virgin Media, that has its own network. This, however, begs the question of the effect of competition from SBB and the ability of other rivals to build their own networks. We consider these next.

[26] Transcript Day 5, page 61, lines 21-31.

Constraint imposed by standard broadband

213. In his analysis of the broadband market, Mr Murray on behalf of BT contends that even with the increasing requirements for more speed, the additional speed offered by SFBB over and above standard broadband is by no means essential for most applications. At the same time, he recognised in his oral evidence that the market trend is towards SFBB:

> "Q. BT Group has made a major investment in the fibre infrastructure needed to provide superfast broadband to premises?
>
> A. It has, yes.
>
> Q. So it's betting on superfast broadband as the future?
>
> A. Initially I think it was a risky bet, but certainly now I think everyone is agreed it's the way forward and discussions have now, to a great extent, moved on to: what is the next thing in terms of ultra fast broadband?"[27]

214. Moreover, the evidence of Mr Matthew for Ofcom is that SFBB is a better quality product and the importance of the differentiation is likely to increase; while SBB may well be sufficient today for many customers, as SFBB becomes more widespread (both in terms of availability and take-up), more applications that require SFBB can be expected to be developed due to a greater potential market. As a consequence, Mr Matthew concludes that as the market tips towards SFBB it seems very likely that a dilution of competition in those services would harm consumers.

215. Ofcom in its market review argues that this period of high expected take-up of (and transition to) SFBB represents a disruption to the market and so is likely to present an opportunity for retailers to win customers from their rivals. Accordingly, this market review period could see a heightened opportunity for retailers (including BT) to compete to attract new subscribers.

216. We consider that, although there is inevitably an element of speculation about how markets will develop, the increasing demand for higher broadband speeds will, in all probability, drive customers to SFBB away from SBB. While SBB

[27] Transcript Day 2, page 58, lines 4-10.

may therefore still be exerting a moderating influence on BT's ability to squeeze its competitors in SFBB, this will diminish over time, including in this review period. It is therefore appropriate for Ofcom to anticipate that the potential for BT to implement a price distortion will intensify over this review period. Accordingly, we reject BT's criticism that Ofcom failed properly to analyse the constraining effect of SBB on SFBB.

Potential for competitors to build their own fibre networks

217. In his witness statement for BT, Mr Bishop contends that Sky and TalkTalk, as well as other new entrants, are able commercially to counter any attempt to marginalise them as competitors by investing in a fibre network themselves, even if only in limited areas. In his witness statement, Mr Clarkson for Ofcom disputes this on the basis that, although there are alternative providers investing in their own fibre networks, beyond Virgin Media these are very small scale and not expected to have any significant impact on the broadband market during the market review period. Mr Blumberg, on behalf of Sky, refers to a number of trials of network construction that are being undertaken by Sky and TalkTalk in South Harrow in London, by Sky, TalkTalk and Cityfibre in York, in Wandsworth and Swadlincote, and the delivery of SFBB over Sub Loop Unbundling. However, he notes the small scale of these trials and concludes that as a result, Sky will continue to rely on regulated access to GEA (BT's VULA product) from Openreach for the foreseeable future to provide competing SFBB services.

218. In our view, the evidence put forward by Ofcom and the interveners is compelling. We do not anticipate that investments by CPs building their own networks will have a material effect on the provision of SFBB in the market review period. BT has not shown that Ofcom's analysis in this regard is in error.

Constraint imposed by the threat of re-entry

219. In his witness statement, Mr Bishop contends that, even if BT could impose a price distortion and had an incentive to do so, this would not be expected to cause harm because in the event that BT did marginalise its downstream VULA rivals and then later sought to increase its retail prices, these rivals would likely find it profitable to re-enter the market at those new higher retail prices. In such an event, the attempt by BT to raise its own prices would be frustrated and the harm to consumers eliminated. Mr Bishop considers that the costs of re-entry of BT's VULA-based rivals into the provision of SFBB services are likely to be low, given that it is likely that BT's downstream rivals will be able to use their existing customer-facing infrastructure and network for standard broadband services to upgrade to SFBB services, simply by paying the VULA access fee to BT to upgrade these customers to SFBB and incurring some investment costs in upgrading the services when providing SFBB for the first time.

220. Mr Matthew for Ofcom disputes these assertions in his witness statement on the basis that it is highly unlikely that Sky or TalkTalk's ability to exert a constraint in SFBB would be unaffected by their exclusion from SFBB for a period or by a diminution of their position to retail broadband more generally. He argues that these markets are not contestable purely in the sense that the costs of exiting and re-entering are low, and he points to the economies of scale that arise in respect of marketing, customer acquisition costs, backhaul and product bundling. He believes that customer inertia and switching costs are significant and that if BT raised its VULA prices once to exclude competition then there would be nothing to stop it from doing this again after competitors had re-entered, thereby driving them out for a second time and indefinitely thereafter.

221. In our view, it is not compelling – for the reasons put forward by Ofcom – that the constraint imposed by the threat of re-entry removes the risk of BT implementing a price distortion.

222. BT also contends that there would be limited impact in the current market review period if TalkTalk and Sky were excluded as any effects could be assessed in the next review period, so that harmful effects could be limited at that stage. Ofcom's responds that some consumer harm is likely in this period so that this must be addressed now. If BT's conduct distorts long run competition then future regulation may not fully remedy the situation and therefore it is appropriate to address risk of future harm now to avoid need for more intensive regulation later. As noted above at paragraph 216, we agree with Ofcom that some consumer harm would be likely to occur in this market review period and that it is preferable to address this risk now rather than waiting till the next review period.

Tribunal conclusion – Assessment of incentives and market factors

223. Overall, we consider that while there may be some market factors that potentially exert a mitigating influence on BT's incentives to engage in a price squeeze, they do not, individually or in combination, remove the risk of BT engaging in one. Possible short-run loss in profits of Openreach from reduced custom, and in BT Consumer from reduced margins in the short run, need to be set against increased retail profits from diminished competition in the long-run. While competition from Virgin Media and SBB may have a minor constraining influence, Virgin Media has limited market penetration and the constraining effect of SBB is likely to diminish over time. The costs of competitors building their own networks are likely to be prohibitive and there may well be significant hurdles to companies re-entering the retail market once they have abandoned it. There is little merit in BT's argument that there is limited adverse impact on consumers in the current market review period if TalkTalk and Sky are excluded.

224. We therefore conclude that BT has not shown that Ofcom erred in its market analysis, either in the assessment of BT's incentives or the analysis of market factors that may remove the risk of a price squeeze.

BT's past conduct

225. Mr Bishop notes in his witness statement that Ofcom itself has concluded recently that BT is not currently engaging in a margin squeeze as prohibited by Article 102 and that BT has effectively been incentivising its rivals that use VULA to upgrade their customers to the fibre network, by investing in services that they require such as self-install, fibre voice access and others. He contends that this behaviour does not appear to be consistent with incentives to engage in a price distortion.

226. Mr Matthew for Ofcom responds that lack of a margin squeeze to date does not indicate that BT has not had such incentives in the past or would not have them going forward. He points out that BT's conduct to date has been constrained by current and future potential regulatory obligations and that its incentives to engage in a price distortion are likely to intensify as the SFBB market develops. He disputes the assertion that the specific BT investments cited by Mr Bishop are evidence of a general attempt by BT to incentivise its rivals to upgrade their customers to fibre network and he notes that their sales of VULA based products are currently much lower than BT's.

227. Ofcom is required to assess whether there are relevant risks in the market review period of adverse effects on end users arising from BT imposing a price squeeze. In our view, past conduct is of significance in that regard but not conclusive; as noted above, it is not necessary as a matter of law, for Ofcom to demonstrate that BT has engaged in or attempted to engage in a price distortion (*Hutchison 3G (CAT)* at [286]). Market conditions are changing and past conduct is influenced by both existing and prospective regulation. In determining the appropriate form of future regulation Ofcom has to look forward as well as back and consider this in light of prospective market developments. In our view, Ofcom correctly concluded that the

absence of the implementation of a price distortion (or an Article 102 margin squeeze) by BT to date should not be regarded as conclusive in establishing whether or not there is a relevant risk of it occurring in the future.

Risks of regulation

228. BT asserts that Ofcom erred by not considering in Section 3 of the Statement (which deals with BT's incentives to implement a price distortion) the risks associated with regulatory intervention. Ofcom denies this on the basis that consideration of such risks is relevant in the context of the CMA's consideration of specified price control matters, and that in any event they were properly taken into account in the Statement.

229. In the Statement, Ofcom acknowledges that increasing the VULA margin is not a costless exercise (paragraph 3.114). It considers three possible adverse effects. The first is the risk of productive inefficiencies arising from the higher margin supporting inefficient providers. The second is the risk that the higher margins will result in increased BT retail prices for consumers. The third is reduced incentives to invest in fibre networks if increased margins are achieved by lowering VULA prices. Ofcom considers these possible adverse effects in the context of three options for determining the appropriate margin – allowing a competitor with the same costs as BT to compete against it, allowing a competitor with slightly higher costs than BT to match its offers profitably, and allowing a competitor with slightly higher costs to undercut BT profitably (paragraphs 3.114 - 3.130). It concludes that, while the first option may be ineffective in preventing the adverse effect of a price squeeze for competitors that face higher costs than BT, the adverse effects of the third option on efficiency, consumers and incentives to invest might outweigh its benefits. It therefore concludes that the second option strikes an appropriate balance.

230. We believe that Ofcom has correctly evaluated the potential adverse effects of regulation and the trade-off that exists in promoting effective competition

through a margin requirement with its potential adverse effects on efficiency, consumers and incentives to invest in fibre networks.

Quantitative analysis

231. Ofcom did not undertake a quantified analysis of BT's incentives. BT contends that this is one of the manifest defects in Ofcom's assessment of BT's incentives and that, in order properly to assess BT's incentives to engage in a price squeeze, it is important to consider in turn the likely magnitude of the loss of profits for Openreach and the likely magnitude of the potential gain for BT Consumer.

232. Ofcom's response to this criticism is that a quantitative analysis would be extremely complex, would itself involve a series of judgements, and would be unlikely to advance matters.

233. We agree with Ofcom's view that a quantitative analysis is unlikely to be helpful in the context of its analysis of BT's incentives in this case. We consider that, in light of the rapidly changing market conditions and consumer preferences, Ofcom was justified in not undertaking such an analysis given the complexities involved and the likelihood that it would not be sufficiently informative about the relevant risk of a price squeeze.

Tribunal conclusion

234. We conclude that BT has not shown that Ofcom erred in its market analysis. Ofcom has sufficiently demonstrated that there is at least a risk that BT has incentives to implement a price distortion; the constraints imposed by competitors, SBB, the ability of competitors to build their own fibre networks and the possibility of re-entry by competitors do not, individually or taken together, remove that risk; the past conduct of BT is also not a sufficient guarantee against the risk of such conduct occurring in the future. Neither has Ofcom placed undue reliance on market shares. Ofcom has adequately

considered the risks associated with regulatory intervention. Moreover, in the context of the factual matrix that pertains in the context of the Statement under consideration, we are of the view that quantification would not have advanced matters. We therefore reject all of BT's contentions that Ofcom erred in its analysis of the market.

6. CONCLUSION

235. For the reasons set out above and pursuant to section 195(2) of the 2003 Act, the Tribunal unanimously dismisses Ground 1 of BT's Amended Notice of Appeal.

Andrew Lenon Q.C. William Allan Prof. Colin Mayer

Charles Dhanowa O.B.E.,
Q.C. (*Hon*) 24 March 2016
Registrar