O_2/T-Mobile 3G infrastructure sharing agreement: case COMP/C1/N.38.370

UK response (non-confidential/public) to the Commission's notice pursuant to Article 19(3) of the Council Regulation No. 17

10 October 2002

Summary

1. Retail competition in the mobile market is driven by network competition, which has delivered many benefits to UK mobile consumers in recent years. The UK notes that there are considerable short term commercial challenges in rolling out third generation (3G) networks. However, there needs to be a clear demonstration of the prospective benefits to consumers of this agreement if it is to be given clearance by the Commission.

2. The parties argue that consumers will benefit through the delivery of faster, more innovative 3G services at lower prices[1], but give limited evidence to justify this. The agreement appears to limit network competition in so far as it limits competition on coverage and quality between the two parties. The UK is particularly concerned about clauses in the agreement, which appear to have the effect of limiting network competition in the Initial Build Area (IBA). Moreover, the agreement may facilitate tacit collusion between the two parties and there may be spill-over effects which weaken competition at the retail level. Cost savings for the parties are referred to, but these may not be passed onto consumers unless competition is sufficiently strong.

3. The UK does have concerns around the potential for site foreclosure, but considers that the market for sites is sufficiently competitive for these to be relatively minor. Difficulties for another operator gaining access to sites may be limited to particular circumstances in isolated areas.

Recommendations

4. In view of the significant reservations referred to, if the Commission is minded to grant an exemption, this should be subject to clear conditions.

- the exemption should lapse within a relatively short time period (within three years of the commencement of the agreement) to allow for review of actual benefits to consumer (this is subject to the EU Modernisation proposals);

[1] Art 19(3) notice, para 27.

- to amend the agreement so that, in the IBA, both the revision of respective radio plans to make use of possible common locations[2] and the option to offer the other party roaming[3], are prohibited;
- the exemption should be conditional on the management and control of the parties remaining the same, and there should be an obligation to notify the Commission of any change in ownership; and
- it might be desirable to have independent auditing of the confidentiality arrangements[4], to be subject to periodic reports to the Commission.

Competition issues for the UK

5. Oftel's review[5] of the mobile market in 2001 concluded that competition was not effective at the retail level, and moreover, that the competitive conditions at the retail level were dictated by competitive conditions at the network level.

6. The impact of this agreement will take the form of a trade-off between cost savings and a reduction of the effectiveness of competition at the network level. In general, the greater the degree of infrastructure sharing, the greater the cost savings for the operators, but the greater the likelihood of dampened competition at the network level. This may be due to weaker competition due to a smaller number of players, and weaker competition due to greater ease of collusion amongst the parties to the agreement. Any collusive behaviour would make it less likely that cost savings will be passed on downstream.

Are there benefits and would these be passed on to consumers?

7. One report[6] suggests that the capital expenditure cost for a new entrant to build a 3G network in the UK could amount to £1bn to £2bn over several years. The parties argue that the agreement will speed up the provision of 3G services and enable the parties to reduce 3G network deployment costs[7]. These savings result from economies of scale produced from network sharing. However, Oftel's model for second generation (2G) network sharing (used in Oftel's review of calls to mobile phones) does not exhibit strong economies of scale outside rural areas (ie where capacity rather than coverage is the driver of investment).

8. Whether or not these cost savings are likely to be passed on downstream depends on the intensity of network competition. The parties argue that consumers will benefit through the delivery of faster, more innovative 3G services at lower prices[8]. They also state that they will as a result of their co-operation not produce standardised services to end users but will continue to compete directly on content applications,

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[2] Art 19(3) notice, para 19(ii).
[3] Art 19(3) notice, para 19(v).
[4] Art 19(3) notice, para 18.
[5] *Effective competition review: mobile*, Oftel, 26 September 2001, see www.oftel.gov.uk/publications/mobile/mmr0901.htm.
[6] Enders Analysis, July 2002, and company announcements. Estimates range due to assumed network coverage and quality.
[7] Art 19(3) notice, para 27.
[8] Art 19(3) notice, para 27.

retail pricing, wholesale pricing, terms and conditions of service, channel to market and customer care services and marketing.

9. It may be true that 3G products should offer more value added than 2G products, and this may increase retail competition. However, network competition will remain fundamental to competition at retail level. Whilst Oftel's 2001 review only analysed 2G services, it is unclear at present how different the situation will be for 3G services. However it is clear that network quality of service will be important for data services in terms of maximum data rates, and the bit error rates, on which 3G value added data services will rely.

10. There are currently significant financial hurdles and commercial challenges for 3G operators in effecting roll out of their 3G networks. Nonetheless, it would be a serious concern if the agreement were to have the effect of a material reduction of competition between 3G operators, and was therefore detrimental to consumers. Although, it is recognised that there is a balance to be struck in this regard, emphasis should be placed, where possible, on maintaining the strength of competition among a limited number of actual competitors, particularly given the high entry barriers in the market for mobile services.

What are the possible restrictions in competition?

11. There are three main types of possible effect in restricting competition: a reduction of the extent of infrastructure over which competition occurs, a possible foreclosure of site availability to the other three operators and spill-over effects weakening competition.

A reduction of the extent of infrastructure over which competition occurs

12. In general, the extent of competition can be envisaged as lying between two extremes: from competition between operators that fully duplicate infrastructure to competition in services delivered over a single 'common carrier' network (the service provider model). The extent of competition between separate, duplicating networks will tend to be greater than between service providers. Service providers take as given the variety and cost of the underlying network services and compete primarily in terms of the costs of retailing and customer service factors. Competing networks compete in terms of the full range of costs and the quality and variety of network and retail services. Competition at the network level positively enhances competition at the service level. In an infrastructure sharing scenario, there would be arguably less competition on issues such as network coverage and quality. In 3G, there are additional network performance parameters for data transmission where competition might be dampened as well.

13. In the IBA the agreement allows the parties to revise radio plans to make best use of common locations[9]. It also allows roaming to be offered to the other party, for such time as it does not have 3G radio coverage in a particular part of the IBA[10]. If these options were exercised there would be conflict with the party's submission that

[9] Art 19(3) notice, para 19(ii).
[10] Art 19(3) notice, para 19(v).

competition at the network level is fully maintained in the Initial Build Area[11]. Economies of scale through infrastructure sharing are not strong outside rural areas. As network competition will be important, particularly in the initial stages of development of 3G infrastructure in higher densely populated areas, it is recommended that these options are removed.

Site foreclosure

14. There could be a concern that the agreement would foreclose access to sites by other parties. In a situation of scarcity of sites, the fact that two parties have agreed to reserve space on sites for the other might mean that there is less opportunity for others to find space on those sites.

15.It is true that to provide full coverage for 3G, a considerable number of sites will be required. Incumbent operators are clearly in a privileged position as they already have 2G sites. However, many existing sites are not owned or controlled by the incumbents but by third parties such as NTL and Crown Castle. Although planning issues have become more challenging, this would be the case whether there was an agreement between T-Mobile and 0_2 or not.

16. Overall, we judge that the potential for site foreclosure is likely to be relatively minor. There is a wide range of potential landowners of sites, and site sharing by two or more operators is common. Any difficulties for another operator gaining access to sites may be limited to particular circumstances in isolated areas, where locally there is a strict interpretation of the planning regulations by the planning authority.

Spill-over effects weakening competition

17. It is possible that the infrastructure sharing agreement could spill-over into facilitation of less aggressive competition or even collusion between the operators in downstream retail markets. Such effects could arise informally, facilitated by the agreement eg from the co-ordination of network arrangements, the closeness of the relationship between the operators and the recognition of common interest in reducing retail competition. Tacit collusion can be assisted where one competitor has a credible threat that it can retaliate quickly and effectively by 'punishing' the other if it competes vigorously in the retail market. These threats can then act as a deterrent, such that the result is weakened competition. It is conceivable that infrastructure sharing could facilitate such behaviour, by making each operator dependent upon the infrastructure of the other.

[11] Art 19(3) notice, para 27.