



Determination to resolve a Dispute between O2 and each of Vodafone and H3G about wholesale voice call termination charges in October 2010

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Final Determination

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Section 1

Summary

- 1.1 This determination (the “Determination”) sets out our resolution of the dispute brought by Telefónica O2 UK Limited (“O2”) against each of Vodafone Ltd (“Vodafone”) and 3G UK Ltd (“H3G”). We refer to this dispute as the “Dispute” and we refer to O2, Vodafone and H3G as the “Parties”.
- 1.2 The Dispute relates to the wholesale voice call termination charges set by each of Vodafone and H3G to O2 in October 2010 (the “October 2010 charges”). O2 considers that the October 2010 charges are an example of “flip-flopping”. O2 describes flip-flopping as the practice of changing wholesale voice call termination charges on a monthly basis, and dramatically increasing the weekend charges in certain of those months.
- 1.3 On 12 April 2011, O2 submitted the Dispute to Ofcom, claiming that it was not fair and reasonable for each of Vodafone and H3G to levy the October 2010 charges.
- 1.4 Our powers and duties to resolve certain disputes are set out at sections 185 to 191 of the Communications Act 2003 (the “Act”). In accordance with section 186(4) of the Act, on 16 May 2011 we decided that it was appropriate for us to handle the Dispute. We informed the Parties of our decision and published details of the Dispute, including the following scope, on the Competition and Consumer Enforcement Bulletin part of our website (the “CCEB”):

“The scope of the dispute is to determine:

- (i) whether it was fair and reasonable in light of the prevailing regulatory regime for Vodafone and H3G to levy the charges which applied to the purchase of wholesale voice call termination services by O2 during the period October 2010; and*
- (ii) if not, what charges would it have been fair and reasonable for Vodafone and H3G to have levied on O2 for the purchase of wholesale voice call termination services during the period October 2010?”*

Summary of analysis

- 1.5 The following paragraphs summarise the analytical framework that we have used for reaching our Determination and the conclusions we have reached:
 - 1.5.1 The regulatory framework which applied at the time of the October 2010 charges was contained in significant market power (“SMP”) conditions in 2007. It was not suggested that the October 2010 charges failed to comply with those conditions.
 - 1.5.2 We have assessed whether there was a separate, general requirement for the October 2010 charges to be fair and reasonable, as contended by O2. We disagree with O2’s view that case law requires us to carry out a separate assessment of whether the charges are fair and reasonable. The case law cited is distinguishable on the basis that it related to

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circumstances in which no regulatory requirement was in place in respect of the disputed charges (see paragraph 4.18).

1.5.3 We have also considered whether the determination sought by O2 would be consistent with the principle of legal and regulatory certainty. We consider that making such a determination would be contrary to the principle of legal and regulatory certainty, in light of the SMP conditions and our position set out in subsequent consultations.

1.5.4 We have further considered whether the Determination is consistent with our statutory duties. In doing this, we have assessed, in particular, the balance we must strike between the effects on consumers and competition of H3G and Vodafone levying the October 2010 charges.

Draft determination

1.6 On 4 August 2011, we issued our draft determination (the “Draft Determination”)¹ setting out our provisional conclusions in respect of the Dispute and the reasoning supporting those conclusions.

1.7 The Parties and interested parties were given until 19 August 2011 to provide comments on the Draft Determination. We received comments from O2, H3G, Vodafone, Cable & Wireless Worldwide (“C&W”) and Everything Everywhere (“EE”).

Final conclusions

1.8 Having carefully considered and taken into account the responses received, we have concluded that it was fair and reasonable in light of the prevailing regulatory regime for Vodafone and H3G to levy the October 2010 charges. Our Determination is at **Annex 1**.

Structure of the remainder of this document

1.9 An introduction and background to this Dispute is set out in **section 2**; Ofcom’s analysis and reasoning underpinning the Draft Determination is set out in **section 3**; and a summary of the Parties’ and third parties’ submissions on the Draft Determination and our response to those submissions is set out in **section 4**. Given the nature of our final conclusions, Sections 2 and 3 of this document are both identical to those sections of the Draft Determination, save for minor corrections.

¹ http://stakeholders.ofcom.org.uk/binaries/consultations/draft-o2-vodafone-h3g/summary/Flip_flopping_draft.pdf

Section 2

Introduction and background to the Dispute

Dispute resolution

Ofcom's duty to handle disputes

- 2.1 Section 185(1)(a) of the Act provides (in conjunction with section 185(3)) that in the case of a dispute relating to the provision of network access between different communications providers ("CPs"), any one or more of the parties to such a dispute may refer it to Ofcom.
- 2.2 Section 186 of the Act provides that where a dispute is referred to Ofcom in accordance with section 185, Ofcom must decide whether or not it is appropriate to handle it. Section 186(3) further provides that Ofcom must decide that it is appropriate for it to handle a dispute unless there are alternative means available for resolving the dispute, a resolution of the dispute by those means would be consistent with the Community requirements set out in section 4 of the Act, and those alternative means would be likely to result in a prompt and satisfactory resolution of the dispute².

Ofcom's powers when determining a dispute

- 2.3 Ofcom's powers in relation to making a dispute determination are limited to those set out in section 190 of the Act. Except in relation to disputes relating to the management of the radio spectrum, Ofcom's main power is to do one or more of the following:
 - 2.3.1 make a declaration setting out the rights and obligations of the parties to the dispute;
 - 2.3.2 give a direction fixing the terms or conditions of transactions between the parties to the dispute;
 - 2.3.3 give a direction imposing an obligation to enter into a transaction between themselves on the terms and conditions fixed by Ofcom; and
 - 2.3.4 give a direction requiring the payment of sums by way of adjustment of an underpayment or overpayment, in respect of charges for which amounts have been paid by one party to the dispute, to the other.

² The wording of sections 185 and 186 was amended by the Electronic Communications and Wireless Telegraphy Regulations 2011 on 26 May 2011. As the referral of the dispute occurred before this date, Ofcom has considered the dispute in accordance with the provisions in place before 26 May 2011

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- 2.4 Ofcom may also exercise certain other powers in consequence of its consideration of a dispute, including its powers under Chapter 1 of the Act to set, modify or revoke General Conditions³.
- 2.5 A determination made by Ofcom to resolve a dispute binds all the parties to that dispute (section 190(8)).

Ofcom's duties when determining a dispute

- 2.6 The dispute resolution provisions set out in sections 185 to 191 of the Act are functions of Ofcom. As a result, when Ofcom resolves disputes it must do so in a manner which is consistent with both Ofcom's general duties in section 3 of the Act, and (pursuant to section 4(1)(c) of the Act) the six Community requirements set out in section 4 of the Act, which give effect, amongst other things, to the requirements of Article 8 of the Framework Directive⁴.

Ofcom's process for determining disputes

- 2.7 In light of the four month time period within which Ofcom must determine how to resolve disputes (except where there are exceptional circumstances), our *Guidelines for the handling of competition complaints, and complaints and disputes about breaches of conditions imposed under the EU Directives* (July 2004) ("the 2004 Guidelines")⁵ set out the evidence that we require before we will accept a dispute⁶.
- 2.8 The 2004 Guidelines set out the information that a complainant is required to provide when submitting a dispute, including details of any relevant *ex ante* conditions, a clear statement of the scope of the matters in dispute, details of the preferred remedy (with reasons), evidence of commercial negotiations and a statement of an officer of the company that best endeavours have been used to resolve that dispute through commercial negotiation, before bringing it to Ofcom. The purpose of the guidelines is to aid both Ofcom and the parties to a dispute to manage the dispute resolution process effectively.
- 2.9 We determine disputes on the evidence available to us in the time available.

Background

O2's request for resolution of the Dispute

- 2.10 On 12 April 2011, we received a dispute submission from O2 concerning the wholesale voice call termination charges levied by each of Vodafone and H3G in October 2010. The Dispute relates to allegations by O2 that it was not fair and reasonable for each of Vodafone and H3G to levy the October 2010 charges. O2 considers that the October 2010 charges were examples of "flip-flopping".

³ "General Conditions" refer to the Schedule to the notification issued by the Director General of Telecommunications on 22 July 2003 under section 48(1) of the Communications Act 2003, which took effect from 25 July 2003, as amended as at 30 July 2010:

<http://stakeholders.ofcom.org.uk/binaries/telecoms/ga/cvogc300710.pdf>

⁴ Directive 2002/21/EC of 7 March 2002

⁵ <http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/other/guidelines.pdf>

⁶ The 2004 Guidelines were replaced by revised dispute resolution guidelines on 7 June 2011. However, the revised guidelines will not apply to this Dispute, given that we accepted it for resolution prior to the revised guidelines coming into effect.

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- 2.11 Flip-flopping is a term used to refer to a practice whereby it is possible to increase revenues from call termination charges due to an anomaly in the applicable charge control. We have previously described flip-flopping in the following way⁷:

“Flip-flopping works by exploiting the difference in the number of weekends in each month between the prior year and the current year, because the calculation used to monitor compliance with the charge control uses prior year’s volumes. By identifying the months in the current year where the number of weekends differs from the same months in the prior year, prices can be structured to maximise revenues.

“When the number of weekends in a particular month increases from four to five, for example, between the prior year and the current year, a [mobile communication provider] can increase its prices at the weekend and decrease prices in the day and evening. Because the prior year had a lower number of weekends than the current year, the higher price is given a lower weighting for the purpose of calculating compliance. However, in the current year, it gives the provider an extra weekend of revenue at the high price. If the opposite happens in a month and the number of weekends decreases from five to four, the provider can price high in the day and evening, and low at the weekends. If the effect reverses month-on-month, then prices are flipped.”

- 2.12 O2 provided in its Dispute submission the charges that Vodafone and H3G levied in October 2010 and in the preceding and succeeding months (set out in Tables 1 and 2).

Table 1 – Vodafone’s charges

Period		Daytime (ppm)	Evening (ppm)	Weekend (ppm)
From 01/09/10	To 30/09/10	4.4276	4.4276	4.4276
From 01/10/10	To 31/10/10	0.5	0.5	19.7546
From 01/11/10		4.6694	7	0.5

Table 2 – H3G’s charges

Period		Daytime (ppm)	Evening (ppm)	Weekend (ppm)
From 01/09/10	To 30/09/10	4.93	4.93	0.5
From 01/10/10	To 31/10/10	1.0	1.0	19.0
From 01/11/10		5.1	5.1	0.5

⁷ The April 2010 Consultation, paras. 9.117 and 9.118; the November 2010 Consultation, paras. 2.3 and 2.4; see references at paras. 3.26 and 3.32.

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2.13 O2 argues that the October 2010 charges:

2.13.1 had the effect of increasing O2's outpayments by £[X] in the case of Vodafone and £[X] in the case of H3G – relative to O2's outpayments had the Target Average Charge been levied for all periods (day, evening and weekend) in October 2010 (see paragraph 3.6 below for an explanation of the Target Average Charge);

2.13.2 carried a risk of arbitrage, in the sense that the wholesale interconnect charges were higher than many of O2's retail charges for the relevant calls; and

2.13.3 did not provide O2 with any countervailing benefit.

2.14 This Dispute must be considered in the context of the prevailing regulatory regime as set out below and imposed in the context of SMP regulation.

Prevailing regulatory regime

Regulation of wholesale mobile voice call termination

2.15 Wholesale mobile voice call termination (referred to here as "MCT") is the service necessary for a network operator to connect a caller with the intended mobile recipient of a call on a different network. This service is referred to as wholesale because it is sold and purchased by network operators rather than retail customers.

2.16 MCT is provided by all mobile communication providers ("MCPs") who have had number ranges allocated to them. However, only O2, Vodafone, H3G and Everything Everywhere operate national networks and we refer to them collectively as the "national MCPs".

2.17 At the time that the October 2010 charges were introduced, the regulatory regime which applied to mobile termination rates ("MTRs") was that set out in the MCT Statement, dated 27 March 2007 (the "2007 MCT Statement")⁸ as amended by Ofcom's April 2009 charge control amendment⁹ following the judgment of the Competition Appeal Tribunal ("CAT")¹⁰ concerning appeals against the 2007 MCT Statement (see below).

Relevant regulatory conditions

2.18 The regulatory regime established in the 2007 MCT Statement set a number of conditions with which CPs with SMP were required to comply, set out in full at Annex 2 to the Draft Determination and this Determination. The principal SMP conditions which are relevant for the purposes of this Dispute are Conditions MA1 and MA4.

2.19 Condition MA1 states:

"Condition MA1 – Requirement to provide network access on reasonable request

⁸ http://stakeholders.ofcom.org.uk/binaries/consultations/mobile_call_term/statement/statement.pdf.

⁹ http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/CTMAmendment2009final.pdf

¹⁰ http://www.catribunal.org.uk/files/Judgment_1083_1085_MCT_02.04.09.pdf

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MA1.1 Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access. [...]

*MA1.2 **Subject to condition MA1.3**, the provision of Network Access in accordance with paragraph MA1.1 [...] shall be provided on fair and reasonable terms and conditions (including charges) [...] as Ofcom may from time to time direct. [our emphasis]*

MA1.3 The charges for Calls as covered by SMP conditions MA3 and MA4 [...] below shall be as set out in those conditions, but only for the duration of those conditions."

- 2.20 Condition MA1.2 provides that network access must be provided on fair and reasonable terms (including charges). Condition MA1.3 imposes an obligation to comply with the charge controls in setting charges for MCT. In this case, the relevant control is that contained in Condition MA4 relating to mobile-to-mobile calls.
- 2.21 Condition MA4 goes on to set out the charge control for mobile-to-mobile interconnection, specifying an average charge over a period of a year allowing for variations in prices at any time and by time of day.
- 2.22 In May 2007, BT and H3G appealed the 2007 MCT Statement to the CAT. On 2 April 2009, the CAT remitted the matter back to Ofcom with a direction to Ofcom to revise the charge control in accordance with revised MTRs as determined by the Competition Commission ("CC")¹¹. The CC determined that MTRs should be reduced to the pence per minute charges in real 2006/07 prices (original charges set in the 2007 MCT Statement are shown in brackets) set out below in Table 3.

Table 3 – MTRs determined by the Competition Commission

	2007/08	2008/09	2009/10	2010/11
Vodafone & O2	5.2 (5.5)	4.7 (5.4)	4.4 (5.2)	4.0 (5.1)
T-Mobile & Orange	5.7 (6.0)	5.0 (5.7)	4.5 (5.4)	4.0 (5.1)
H3G	8.9 (8.9)	6.8 (7.5)	5.5 (6.7)	4.3 (5.9)

- 2.23 Following the CAT's judgment, on 2 April 2009 Ofcom published revised SMP conditions, which complied with the CC's determination, including amending the prices set out in SMP Conditions MA3 and MA4. No amendments were made or required to be made to SMP Condition MA1. The amendments to the 2007 MCT Statement took effect from 3 April 2009¹².

¹¹ Under section 193 of the Act, the CAT must refer to the CC for determination "price control matters" in any appeal. In deciding the appeal, the CAT must decide the price control matters in accordance with the CC's determination, unless the CAT decides that the CC's determination would fall to be set aside on the principles applying on an application for judicial review.

¹² For further detail see:

http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement/CTMAmendment2009final.pdf.

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- 2.24 The prevailing regulatory regime in place at the time of this Dispute therefore comprises the SMP Conditions MA1 and MA4 as set out in the 2007 MCT Statement and as amended by Ofcom's April 2009 charge control amendment.
- 2.25 During 2009 and 2010, Ofcom consulted on a new regulatory regime for MCT to apply after the regulation set by the 2007 MCT Statement expired on 31 March 2011. In March 2011, Ofcom issued a further Wholesale Mobile Voice Call Termination Statement (the "2011 MCT Statement")¹³ setting new charge controls with effect from 1 April 2011. The new controls were set in such a way as to prevent the practice of flip-flopping from 1 April 2011 onwards.

Preliminary arguments of the Parties

- 2.26 O2 notes that its objections to the October 2010 charges are not based on any allegation of breach of the charge controls in place at that time.
- 2.27 In its submission, O2 described how it had expressed its opposition to Vodafone and H3G's proposed charges. Despite negotiation, O2 and Vodafone and O2 and H3G were unable to reach an agreement.
- 2.28 H3G argued that there could be no dispute because O2 requested H3G to withdraw the change outside the time period contemplated by the Interconnection Agreement, and because O2 did not dispute the change of rate and accordingly terminate the Interconnection Agreement. In H3G's view, O2 should therefore be taken to have accepted the charges.
- 2.29 Having considered O2's submission and comments made by Vodafone and H3G, we were satisfied that the Dispute qualifies as a dispute falling within section 185(1)(a) of the Act between CPs relating to network access in respect of the terms on which each of Vodafone and H3G are prepared to interconnect with originating CPs ("OCPs") for the termination of voice calls hosted on their networks. O2 and each of H3G and Vodafone have been unable to agree a price for call termination on H3G's network and commercial negotiations have reached an end.
- 2.30 On 16 May 2011 we informed O2, Vodafone and H3G of our decision that it was appropriate for us to handle the Dispute on the basis of section 186(3) of the Act. We did not consider that there were alternative means available for resolving the Dispute which would be likely to provide a prompt and satisfactory resolution.

The scope of the Dispute

- 2.31 Having considered the Parties' views, we published the following scope of the Dispute in the CCEB on 16 May 2011:

"The scope of the dispute is to determine:

- (i) whether it was fair and reasonable in light of the prevailing regulatory regime for Vodafone and H3G to levy the charges which applied to the purchase of wholesale voice call termination services by O2 during the period October 2010; and*

¹³ http://stakeholders.ofcom.org.uk/binaries/consultations/mtr/statement/MCT_statement.pdf.

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(ii) *if not, what charges would it have been fair and reasonable for Vodafone and H3G to have levied on O2 for the purchase of wholesale voice call termination services during the period October 2010?"*

2.32 Our analysis and conclusions are based on the regulatory regime prevailing in October 2010, and in particular SMP Conditions MA1 and MA4.

Interested Parties

2.33 Cable & Wireless Worldwide, Everything Everywhere and Gamma have written to us to state that they are interested in this Dispute¹⁴.

¹⁴ Letter from Nick Harding (C&W) to Paul Dean (Ofcom), dated 18 May 2011; letter from Robyn Durie (Everything Everywhere) to Paul Dean (Ofcom), dated 19 May 2011; letter from Peter Farmer (Gamma) to Paul Dean (Ofcom), dated 20 May 2011.

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Section 3

Analysis of the Dispute

Introduction

- 3.1 This section sets out our analytical framework for resolving the Dispute and our assessment of the issues against this framework as set out in the Draft Determination.
- 3.2 The analytical framework is intended to address the scope of the Dispute, which is to determine:
- (i) *whether it was fair and reasonable in light of the prevailing regulatory regime for Vodafone and H3G to levy the charges which applied to the purchase of wholesale voice call termination services by O2 during the period October 2010; and*
 - (ii) *if not, what charges would it have been fair and reasonable for Vodafone and H3G to have levied on O2 for the purchase of wholesale voice call termination services during the period October 2010?"*

Analytical framework

- 3.3 Considering whether we should exercise our discretion in this case to direct H3G and/or Vodafone to make repayments to O2 requires us to make an assessment of what is fair and reasonable in light of the prevailing regulatory regime.

The 2007 MCT Statement

- 3.4 As set out in paragraph 2.18 above, the prevailing regulatory regime relevant to the resolution of this Dispute is found in SMP Conditions MA1 and MA4 as set out in the 2007 MCT Statement and as amended by Ofcom's April 2009 charge control amendment.
- 3.5 SMP Condition MA1 sets out the national MCPs' (then referred to as "MNOs") obligations to provide network access on reasonable request, as well as their obligations in relation to the terms on which network access is provided.
- 3.6 SMP Condition MA4 sets out in detail the charges which apply to network access in relation to mobile-to-mobile calls. SMP Condition MA4.1 states that the national MCPs must ensure that their Average Interconnection Charges ("AIC") do not exceed the Target Average Charge ("TAC") during each year of the charge control. The TAC is defined in SMP Condition MA4.4, and provides a price in pence per minute for each of the national MCPs, which each MCP may not exceed on average in each relevant year.
- 3.7 SMP Condition MA3 sets out the charges which apply to network access in relation to fixed-to-mobile calls and applies in a substantially similar way to SMP Condition MA4.

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Arguments of the parties

- 3.8 O2 has not alleged that either H3G or Vodafone failed to comply with the charge controls. However, it argues that it was not Ofcom's intention in setting a charge control on MTRs that it would permit MCPs to engage in flip-flopping.
- 3.9 H3G and Vodafone both contend that they complied with the obligations imposed on them by the 2007 MCT Statement.
- 3.10 H3G notes that SMP Condition MA1.2, which states that Network Access shall be provided on fair and reasonable terms and conditions, is expressed to be subject to SMP Condition MA1.3. H3G argues that SMP Condition MA1.2 only applies to charges not covered by SMP Condition MA4.
- 3.11 H3G also argues that transit traffic is not within the scope of the Dispute, as it is not subject to the provisions of the interconnection agreement between O2 and H3G.
- 3.12 It has also been argued that flip-flopping is *per se* not fair and reasonable and in every case therefore breaches SMP Condition MA1.

Ofcom's preliminary view

- 3.13 The October 2010 charges are mobile-to-mobile interconnection charges within the meaning of SMP Condition MA4. Therefore by virtue of SMP Condition MA1.3, H3G and Vodafone were at all times required to comply with the control of mobile-to-mobile interconnection charges set out in SMP Condition MA4 in relation to the October 2010 charges. It does not appear to be disputed that the October 2010 charges were subject to this charge control.
- 3.14 Condition MA1.2 which relates to the provision of network access on fair and reasonable terms does not apply to the October 2010 charges since Condition MA1.2 is expressly subject to Condition MA1.3.
- 3.15 As set out in the 2007 MCT Statement:
- "A charge control is distinct from an obligation that charges should be cost oriented or 'fair and reasonable', in that an upper limit on prices is directly set by Ofcom.[...]"¹⁵*
- 3.16 Specifically, the 2007 MCT Statement also explained why MTRs which are subject to a charge control are not also subject to the "fair and reasonable" condition:
- "In SMP condition MA1.3, Ofcom sets out that the charges for 2G/3G calls as covered by the charge control SMP conditions MA3 and MA4, shall be as set out in those conditions rather than as set out in condition MA1.1 (fair and reasonable), but only for the duration of those conditions. Ofcom has included this condition to ensure that the MNOs have certainty in this context of what the appropriate charges should be for the provision of such calls [...]. The charges for any other services within this market which are not subject to the charge controls [...] would however be subject to the obligation that these charges [...] should be fair and reasonable."¹⁶*

¹⁵ 2007 MCT Statement, paras. 8.68 to 8.70.

¹⁶ 2007 MCT Statement, para. 10.27.

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- 3.17 Accordingly, the October 2010 charges are subject to Condition MA1.3 and Condition MA4 but are not subject to Condition MA1.2 relating to fairness and reasonableness.

An additional ‘fair and reasonable’ test

Arguments of the parties

- 3.18 O2 has argued that Ofcom should conclude that H3G and Vodafone’s respective MTRs are neither fair nor reasonable in the light of established law. O2 relies on the judgment of the CAT in the *TRD* case¹⁷ to suggest that there is an *additional* general obligation on Ofcom to ensure that the rates set are fair and reasonable, which it argues provides guidance for Ofcom to help it resolve disputes of this nature. In particular, O2 argues that the *TRD* case means that:
- 3.18.1 in the context of a dispute that arises where one of the parties is trying to vary the terms of an existing commercial agreement, the onus lies on the party proposing the variation to provide to the other party and to Ofcom the justification for the change in the existing terms – in this case, O2 contends that there has been no such justification;
 - 3.18.2 there is no suggestion that the cost incurred by H3G and Vodafone in providing MCT services had changed in such a way as to justify the new charges for October 2010;
 - 3.18.3 Ofcom should benchmark the charges for the MCT services – O2 suggests that a suitable benchmark would be either the charges levied in September or the TAC; and
 - 3.18.4 Ofcom’s other regulatory objectives would be met by upholding O2’s rejection of the October 2010 charges, given Ofcom’s previous statements that flip-flopping is undesirable from the perspective of its general duties.
- 3.19 H3G argues that the circumstances of the *TRD* judgment can be readily distinguished from those underlying this Dispute. It notes in particular that the decision was reached in the context of 3G wholesale mobile voice call termination rates that were subject to a “fair and reasonable” SMP condition but were *not* subject to a charge control.
- 3.20 H3G and Vodafone note that, in any event, flip-flopping had been engaged in by MCPs prior to the October 2010 charges. H3G argues that no justification was therefore needed for the October 2010 charges, as it was part of a normal pricing pattern. Vodafone comments that O2 has adduced no compelling reason underpinning its rejection of the October 2010 charges.
- 3.21 H3G argues that the fact that the October 2010 charges may have been detrimental to O2’s business does not in itself make them unfair and unreasonable. H3G notes that it has no obligation to, and in any event could not, make pricing decisions designed to avoid any detriment to O2 and its other competitors. O2’s argument would mean that no time of day variations would ever be possible, contrary to the express provisions of the 2007 MCT Statement.

¹⁷ *T-Mobile and others v Ofcom* [2008] CAT 12.

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Ofcom's preliminary view

- 3.22 The *TRD* case involved a dispute in which no charge control applied to the charges in question.
- 3.23 However, as set out in paragraph 3.13 above, the October 2010 charges were specifically subject to a charge control. In light of the charge control, the SMP conditions further specifically excluded an additional assessment of "fair and reasonable".
- 3.24 Ofcom had explicitly decided that a "fair and reasonable" condition should not apply to charges which were the subject of the charge control. If a general fair and reasonable requirement were to apply in this case, this would fundamentally alter the explicit position taken in the 2007 MCT Statement, which was not overturned in the subsequent appeals.
- 3.25 We therefore consider that the guidance provided by the *TRD* case is not relevant for the purpose of this Draft Determination insofar as it is claimed that it has the effect of imposing an additional requirement that charges are fair and reasonable.

Legal and regulatory certainty

Arguments of the parties

- 3.26 O2 argues that Ofcom's decision not to amend the charge control to eradicate flip-flopping does not reflect a judgement that flip-flopping is acceptable. On the contrary, O2 considers it clear that Ofcom believes flip-flopping to be undesirable. O2 argues that, in any event, Ofcom should balance the need to be consistent with the regime set by the 2007 MCT Statement and the need to be consistent with its proposals from the MCT Consultation in April 2010 (the "April 2010 Consultation")¹⁸ onwards.
- 3.27 O2 also submits that it was not Ofcom's intention that the regime set by the 2007 MCT Statement should permit flip-flopping; flip-flopping was simply a loophole in that regime. In any event, O2 argues that it would be wrong in law for other MCPs to argue that they are allowed to deploy flip-flopping simply because the 2007 MCT Statement did not prevent them from doing so; the CAT's judgment in the *TRD* case means that dispute resolution applies in addition to *ex ante* and *ex post* obligations.
- 3.28 H3G and Vodafone argue that O2's position suggests either a retrospective application of aspects of the new price control, or a change to SMP Conditions MA1 and MA4. H3G states that Ofcom was aware of flip-flopping prior to the introduction of the October 2010 charges, but chose not to investigate or take any action to close the loophole. Further, H3G submits that Ofcom assessed H3G's compliance with its price control obligations and confirmed H3G's compliance. H3G argues that this created a legitimate expectation that flip-flopping was an acceptable practice during the term of the 2007-2011 price control. H3G also argues that a finding in favour of O2 would amount to retrospective amendment of that price control, contrary to the rule of law.
- 3.29 Vodafone also argues that Ofcom had previously indicated that it only intended to address flip-flopping on a prospective basis. Vodafone maintains that it only started to engage in flip-flopping in January 2010 as a response to other MCPs engaging in

¹⁸ http://stakeholders.ofcom.org.uk/binaries/consultations/wmctr/summary/wmvct_consultation.pdf

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flip-flopping. It had met with Ofcom prior to this, to discuss the issue. Vodafone states that Ofcom did not indicate at that time that it intended to address the issue through enforcement action. Vodafone claims that Ofcom's conduct created a legitimate expectation that variations in the level of termination rates would be permitted. Like H3G, Vodafone considers that a finding in favour of O2 would amount to Ofcom changing its position retrospectively.

Ofcom's preliminary view

- 3.30 As set out in paragraphs 2.18 to 2.25 above, the prevailing regulatory regime for mobile-to-mobile calls during the relevant period comprised the charge control set out in SMP Condition MA4 in accordance with the requirement in SMP Condition MA1.3 of the 2007 MCT Statement. To now apply any other regulatory regime with retroactive effect would be contrary to the principle of legal and regulatory certainty.
- 3.31 This is further supported by our position taken in our consultations in 2009 and 2010 leading up to the 2011 Statement whereby Ofcom identified concerns with flip-flopping, but decided not to modify the charge control going forwards during the time the charge control was still in place. Specifically, we concluded in April 2010 that:
- "We want to close this loophole in the new charge control. This is because left unaddressed, we believe it would have an adverse effect on purchasers of MCT and, ultimately, on consumers during the period of this market review"¹⁹.*
- "Notwithstanding [...] concerns about the effect of pricing volatility on efficiency, there is clearly an additional impact arising from frequent and radical price changes, allowing the MCPs to gain extra revenue. We have not revised the current charge control condition, considering that any risks of harm need to be considered alongside the need to preserve regulatory certainty once a control is set."²⁰*
- 3.32 This was followed by a further consultation on the design of a proposed charge control in November 2010 (the "November 2010 Consultation")²¹ in which we noted that there was general (though not universal) support for our assessment that flip-flopping harmed the interests of other providers and, indirectly, consumers. We then set out further possible options for setting new SMP conditions, with a view to eradicating flip-flopping in the next charge control period.
- 3.33 In the 2011 MCT Statement, we set regulation that removed the scope for flip-flopping by setting a ceiling on MTRs during each year of the charge control, regardless of time of day or from month to month.
- 3.34 In light of the conclusion set out above that the prevailing regulatory regime at the time of the October 2010 price charges comprised Condition MA1.3 in conjunction with Condition MA4, Ofcom does not consider that it would be consistent with the principles of legal and regulatory certainty to seek to apply any additional obligations to this period. Whilst Ofcom raised concerns over flip-flopping prior to the imposition of the October 2010 charges, we did not amend the charge control or impose any additional regulation. On that basis, the only regulation applicable at the time of the October 2010 charges was the charge control alone.

¹⁹ April 2010 Consultation, para. 9.111.

²⁰ April 2010 Consultation, para. 9.126.

²¹ <http://stakeholders.ofcom.org.uk/binaries/consultations/mtr/summary/mtr.pdf>

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- 3.35 Accordingly, and on the basis that Vodafone and H3G complied with SMP Conditions MA1 and MA4, as set out in the 2007 MCT Statement and as amended by Ofcom's April 2009 charge, it was fair and reasonable in light of the prevailing regulatory regime for Vodafone and H3G to levy the charges which applied to the purchase of wholesale voice call termination services by O2 during the period October 2010.

Additional point of analysis

- 3.36 In relation to O2's concerns over arbitrage, Ofcom notes that it is plausible that MTRs for weekend calls of 19.75 ppm to Vodafone numbers and 19 ppm to H3G numbers were higher than some of O2's retail charges for the relevant calls. However, O2 has not provided any evidence comparing these MTRs to its retail tariffs, nor provided any evidence of how arbitrage arose (or could have arisen) and how this harmed (or would cause harm to) competition (and ultimately consumers).

Assessment of our Draft Determination against Ofcom's statutory duties and Community requirements

- 3.37 As part of our analysis, we have considered our general duties in section 3 of the Act and the six "Community requirements" set out in section 4 of the Act, which give effect, among other things, to the requirements of Article 8 of the Framework Directive²².
- 3.38 We consider that our Draft Determination is consistent with these duties and we would highlight in particular:
- 3.38.1 the duties to further the interests of consumers and promote competition. We noted in the April 2010 Consultation that continued application of flip-flopping in the long term would likely result in higher prices for consumers and impact on competition. The present Dispute, however, relates to a much shorter period where the associated impacts on consumers and competition cannot be any more material and are likely to be much smaller. Moreover, the 2011 MCT Statement has modified the charge control so as to effectively bring flip-flopping to an end. The ongoing effects of any proposed determination on the October 2010 charges on consumers and competition on a prospective basis are therefore negligible. In those circumstances where our determination can have little prospective effect, we consider that this is consistent with the primary duty, the interests of consumers and the promotion of competition being secured by the 2011 MCT Statement; and
 - 3.38.2 our duty to have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted. This includes consideration of the extent to which our proposed action provides legal and regulatory certainty and takes proper account of the basis upon which parties have entered agreements or adopted particular courses of conduct and is discussed in paragraphs 3.30 to 3.35.

²² Directive 2002/21/EC.

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Provisional conclusion

- 3.39 Our provisional conclusion therefore is that, on the basis that Vodafone and H3G complied with the prevailing SMP conditions MA1 and MA4, it was fair and reasonable in light of the prevailing regulatory regime for Vodafone and H3G to levy the October 2010 charges.
- 3.40 In light of our provisional conclusion, we do not need to consider whether it would be appropriate to order repayments and have not sought to address comments from Vodafone and H3G regarding the consequences of repayments or the amounts claimed by O2.

Section 4

Submissions on the Draft Determination and Ofcom's response and conclusion

Responses to the consultation

- 4.1 Ofcom received responses to its Draft Determination from:
- 1) O2;
 - 2) H3G;
 - 3) Vodafone;
 - 4) C&W; and
 - 5) EE.
- 4.2 We have grouped the responses into the following themes:
- 4.2.1 Analytical framework;
 - 4.2.2 Ofcom's statutory duties and Community requirements;
 - 4.2.3 Additional arguments.

Analytical framework

The 2007 MCT Statement

O2's arguments

- 4.3 O2 states that "Ofcom asserts that Vodafone and H3G have complied with their charge controls in the 2010/11 [period], but presents no evidence of this." O2 goes on to question how it can be meaningful to say that the October 2010 charges complied with the charge control, given that "compliance is a matter of not exceeding the [TAC] in the year starting 1 April 2010".

C&W's arguments

- 4.4 C&W disagrees with Ofcom's interpretation of the SMP conditions. It argues that, although SMP condition MA1.2 is expressed to be subject to SMP condition MA1.3, the obligation to provide Network Access "must be on fair and reasonable terms, including meeting the price control provisions" (C&W's emphasis). C&W goes on to argue that, "[g]iven the price control provisions address only the average prices, and are silent on the issue of the specific level of pricing of calls across day/evening/weekend, we must conclude that this aspect reverts to the parent clause, i.e. that the individual rates must be fair and reasonable."
- 4.5 C&W argues that the "background thinking" from paragraph 10.27 of the 2007 MCT Statement "cannot over-ride the final wording of the legal SMP condition".

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Ofcom's response

- 4.6 Ofcom has not determined that Vodafone and H3G have complied with the charge controls. Rather, our conclusions in this dispute are based on the fact that O2 did not allege that there had been a breach of the charge controls and we have seen no evidence that Vodafone or H3G did not in fact comply with them. Ofcom is monitoring compliance with the charge controls as part of a separate project which will be concluded after the time permitted by the Act for resolution of this Dispute has expired.
- 4.7 We do not agree with C&W's interpretation of the SMP conditions. We consider that the clear meaning of expressing SMP condition MA1.2 to be subject to SMP condition MA1.3 is that the October 2010 charges are required to comply with Condition MA1.3 and Condition MA4 but are not required to comply with Condition MA1.2 relating to fairness and reasonableness (see paragraphs 3.13 to 3.17 above).
- 4.8 Our interpretation of the SMP conditions is based on what we consider to be a strict reading of the text, and does not rely on the explanation at paragraph 10.27 of the 2007 MCT Statement. We nevertheless consider that this explanation provides useful contemporaneous evidence as to why the SMP conditions are expressed as they are.

An additional 'fair and reasonable' test: guidance from the *TRD* case

O2's arguments

- 4.9 O2 disagrees with our interpretation of the guidance provided by the CAT in the *TRD* case, as set out in our Draft Determination. It considers that if the *TRD* case is interpreted and applied correctly, "compliance with a charge control does not exclude consideration by Ofcom as to what is fair and reasonable as between the parties".
- 4.10 Further, O2 argues that "the CAT held that in determining a s. 185 interconnection dispute, the test which Ofcom should apply [...] 'can be expressed as requiring Ofcom to determine what are reasonable terms and conditions as between the parties. [...]'. O2 states that "[t]he CAT expressly held that this "fair and reasonable" test was not contingent upon the existence of a specific, pre-existing "fair and reasonable" obligation binding on an operator: the test should be no different whether or not such a pre-existing obligation existed".
- 4.11 O2 therefore argues that "Ofcom has erred in the Draft Determination in stating that the existence of a charge control removes any obligation on Ofcom to consider what is fair and reasonable".
- 4.12 O2 also relies on the *TRD* case in support of its view that H3G and Vodafone were required to justify the October 2010 charges.

H3G and Vodafone's arguments

- 4.13 H3G and Vodafone both agree with our provisional conclusion that no additional "fair and reasonable" test should be imposed. Vodafone notes that this is the logical position, given the existence of a charge control, which is "the most intrusive form of regulation contemplated by the pan-European Common Regulatory Framework [...] expressly designed to limit the scope for an operator found to be in a position of SMP to adversely impact competition and consumers". It further asserts that a determination in favour of O2 would "amount to the retrospective amendment of an

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SMP condition”, contrary to the Court of Appeal’s stated position that “SMP conditions are to operate prospectively”.

Ofcom’s response

- 4.14 Ofcom continues to consider that the guidance provided by the *TRD* case is not relevant for the purpose of this Determination insofar as it is claimed that it has the effect of imposing an additional requirement that charges are fair and reasonable.
- 4.15 We do not accept O2’s view of the guidance provided by the *TRD* case. We consider that the ‘fair and reasonable’ test formulated by the CAT in that case must be considered in light of the facts before the Tribunal. As stated at paragraph 3.22 above, the *TRD* case involved a dispute in which no charge control applied to the charges in question. Nor was there any other relevant SMP condition in place. In our view, therefore, the position adopted by the CAT in that case is not applicable where regulation of charges is in place.
- 4.16 The CAT’s judgment on core issues in the *TRD* case referred explicitly to “the test which Ofcom should have applied in *these disputes*”²³ (emphasis added), and the findings in that judgment are made with reference to the specific facts and circumstances at issue in those particular disputes. General guidance provided by the CAT in that judgment was also expressly identified as addressing appellants’ requests that “clear directions or guidance [be] given to OFCOM as to how to approach the task of resolving *these disputes* in the event that one or more of the grounds of appeal succeed.”²⁴
- 4.17 We also consider it important to take care not to extend the CAT’s guidance in the *TRD* case beyond its proper meaning, given its more recent judgment in *British Telecommunications plc v Ofcom* (the “080 case”)²⁵, in which it said:
- “It is important to distinguish between those aspects of the decision in [the TRD case] that articulate general propositions of law, and those aspects that seek to describe the manner in which the particular appeals before the Tribunal should be resolved.”*²⁶
- 4.18 Moreover, if O2’s position were correct, Ofcom would not have been able to adopt the position set out at paragraph 3.23 above whereby, in light of the imposition of a charge control, Ofcom explicitly excluded the application of an additional “fair and reasonable” obligation. Ofcom does not consider that the effect of the *TRD* judgment is to constrain Ofcom’s discretion in setting SMP conditions in such a manner.

Legal and regulatory certainty

O2’s arguments

- 4.19 O2 considers that a determination in its favour would be consistent with the principles of legal and regulatory certainty, as it should be clear to CPs that “charging practices are subject to separate scrutiny under Ofcom’s dispute resolution regulatory function”.

²³ *T-Mobile and others v Ofcom (Judgment on the Core Issues)* [2008] CAT 12, para. 101.

²⁴ *T-Mobile and others v Ofcom (Judgment on the Core Issues)* [2008] CAT 12, para. 175.

²⁵ *British Telecommunications plc v Ofcom (Termination charges: 0845 and 0870 numbers)* [2011] CAT 24.

²⁶ *ibid.*, para. 437.

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- 4.20 O2 notes the CAT's statement in the *TRD* case to the effect that Ofcom's dispute resolution function is an additional and independent limb of regulation, distinct from its *ex ante* regulatory functions and its *ex post* competition enforcement powers. O2 considers this means that, although the imposition of SMP conditions is a material factor in this Dispute, it is not determinative and "it remains for Ofcom to weigh up all relevant factors, and by so doing to determine whether [...] the charge is fair and reasonable".
- 4.21 O2 also considers that "Ofcom has declared a very clear policy preference in relation to flip-flopping, which is that it is strongly opposed to it". It argues that "Ofcom is required to take account of its policy preferences when determining disputes".

H3G and Vodafone's arguments

- 4.22 H3G and Vodafone both consider that a determination in favour of O2 would run counter to principles of legal and regulatory certainty. Vodafone points to Ofcom's statutory duty to promote regulatory consistency and to ensure that interventions are targeted at those cases where action is justifiable.
- 4.23 Vodafone also argues that "Ofcom created a legitimate expectation regarding the operation of the charge control regime through its conduct". Vodafone asserts that it in fact relied on this expectation.

C&W's arguments

- 4.24 C&W notes Vodafone's comments that it met with Ofcom prior to engaging in flip-flopping conduct, but points out that "in meeting with industry stakeholders, Ofcom never fetter their discretion to handle subsequent Disputes that may arise".
- 4.25 C&W also points out that there was "an ongoing industry disquiet about the issue" well before October 2010, and it was discussed in the April 2010 Consultation as well as in workshops on the subject.
- 4.26 Finally, C&W argues that, while it is desirable that market reviews address all concerns, issues may arise subsequently which need to be addressed. It considers that dispute resolution is important in refining regulation in this regard and expresses concern that our proposed resolution of this Dispute risks signalling that remedying market failures "works solely on the beat cycle of market reviews".

Ofcom's response

- 4.27 Ofcom notes that the principal *ex ante* regulation in place at the time of the imposition of the October 2010 charges was the charge control²⁷. Whilst Ofcom raised concerns over flip-flopping prior to the imposition of the October 2010 charges, the charge control was not amended and neither was any additional regulation imposed at the time. On that basis, the charge control was the only relevant regulation applicable at the time of the October 2010 charges. We continue to consider that it would be inconsistent with the principles of legal and regulatory certainty, in light of the prevailing regulatory regime at the time, to seek to apply any additional obligations in

²⁷ Other SMP conditions (MA2 and MA5) also applied to the October 2010 charges, prohibiting undue discrimination and requiring price publication and notification (as set out in Annex 2). However, these SMP conditions are not relevant to this Dispute.

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the absence of any compelling reasons requiring us to exercise our dispute resolution powers in a conflicting manner.

- 4.28 Our policy preference in relation to flip-flopping as a whole was developed in the context of setting the new charge controls set out in the 2011 MCT Statement, which removed the possibility of flip-flopping. While this policy preference was flagged in the April 2010 Consultation and subsequently, our views in relation to flip-flopping were not finalised until publication of the 2011 MCT Statement at which point the relevant *ex ante* regulation was amended.
- 4.29 We do not, however, accept Vodafone's position that we created a legitimate expectation regarding the exercise of our dispute resolution function in relation to its prices, either generally or specifically in relation to the October 2010 charges. As Vodafone notes, it discussed the issue of flip-flopping with Ofcom, but Ofcom did not undertake that it would not consider flip-flopping conduct if a dispute on that subject were brought to it.
- 4.30 Finally, we accept that market reviews may not anticipate every issue that may subsequently arise and that it may be appropriate, where there are compelling reasons to do so, to exercise dispute resolution powers in a manner which may conflict with the principle of legal certainty. However, any such assessment must take into account all relevant factors in accordance with Ofcom's statutory duties and will depend upon the precise facts before Ofcom.

Ofcom's statutory duties and Community requirements

O2's arguments

- 4.31 O2 states that Ofcom must bear in mind Article 20.3 of the Framework Directive, which is implemented in domestic law by section 185 of the Act and which requires Ofcom to take decisions aimed at achieving the objectives set out in Article 8. This comment is supported by other respondents, including C&W and EE.
- 4.32 O2 asserts that Ofcom "instead elevates one relevant factor (compliance with SMP conditions) to determinative status". It claims that Ofcom has not included its statutory duties and Community requirements as part of its reasoning, instead using them only "as a benchmark by which to check its conclusion".
- 4.33 O2 argues that "Ofcom are bound by their regulatory duties to form a view as to the likely effect on consumers and competition of Vodafone's and H3G's October 2010 charges". O2 also argues that this flows from paragraph 125 of the *TRD* judgment.
- 4.34 O2 refers to the April 2010 Consultation in which "Ofcom found that flip-flopping allowed [MCPs] additional revenue beyond that envisaged by the regulator in setting the relevant charge control, increased risks and costs to [OCPs] and ran counter to the efficiency objectives served by allowing price signals to indicate the relative costs of meeting peak demands".
- 4.35 O2 also argues that "flip-flopping acted against consumers' interests insofar as [O2] purchased [MCT] services" which were the subject of flip-flopped charges, because O2 competes with H3G and Vodafone in the mobile retail market. O2 reiterated and expanded on its quantification of the sums involved and argued that this was likely to have distorted competition for subscribers in the mobile retail market.

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Vodafone's arguments

- 4.36 Vodafone argues that O2 has failed to point to any credible evidence of harm to competition and consumers arising from the October 2010 charges. It argues that “[a]ny determination in favour of O2 would simply involve a transfer of resources between mobile operators, providing O2 with a windfall gain in the process.”

C&W's arguments

- 4.37 C&W refers to the specific objectives it considers Ofcom is required to achieve, including “4(d) *promoting the provision of clear information, in particular requiring transparency of tariffs and conditions for using publicly available electronic communications services*” and “2(b) *ensuring that there is no distortion or restriction of competition in the electronic communications sector*”.
- 4.38 C&W argues that “it is impossible for one or other of these objectives to be achieved under a regime where wholesale rates are being flip-flopped”. It contends that Ofcom therefore has the ability to intervene to ensure that prices are fair and reasonable and also that “[u]nder SMP conditions MA1.2 and MA1.4, terminating [MCPs] are served warning that Ofcom may intervene [...]”.
- 4.39 C&W also contends that the exploitation of the loophole led to additional revenue for H3G and Vodafone, inevitably subsidising originating mobile services.
- 4.40 Finally, C&W's comments refer to “a regime where wholesale rates are being flip-flopped and imply that Ofcom should consider the effects of flip-flopping throughout the duration of this practice”.

Ofcom's response

- 4.41 We agree that Ofcom must have regard to the objectives identified by O2 and C&W in resolving disputes. For the reasons set out at paragraph 3.38 above, we considered that in the context of the particular conduct that is in Dispute (i.e. flip-flopping in October 2010), our Draft Determination was consistent with these duties.
- 4.42 We do not consider the comments received alter our assessment of the Dispute. We maintain that our Determination is consistent with the general duties in section 3 of the Act and the six “Community requirements” set out in section 4 of the Act, which give effect, among other things, to the requirements of Article 8 of the Framework Directive
- 4.43 In relation to the specific objectives identified by C&W:
- 2(b) we considered whether our Draft Determination was consistent with the objective of ensuring that there is no distortion or restriction of competition in the electronic communication sector and concluded that it was consistent with this objective²⁸; and
 - 4(d) we understand that the October 2010 charges were notified to O2 in accordance with the provisions of the interconnect agreements between O2 and, respectively, H3G and Vodafone. We have not seen any evidence that this

²⁸ See para. 3.38 of the Draft Determination.

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resulted in the provision of unclear information either to O2 or to any retail customers.

Additional arguments

C&W's argument

- 4.44 C&W rejects what it sees as a suggestion made by H3G that O2 failed to reject the October 2010 charges and should have subsequently done so by terminating the interconnect agreements. C&W considers it is clear that "any originating operator that did not provide the facility to call one or more terminating mobile operators would lose market share. Since the only way to avoid the rates being directly offered by the terminating mobile operator was to use a transit provider who would be subject to the same rates, it is a specious argument to suggest that if O2 did not like the rates, they could terminate the agreement".

Ofcom's response

- 4.45 We consider it likely that C&W is correct in its argument that terminating the interconnect agreements was not a realistic prospect for O2. However, our Determination does not depend on the contractual arrangements between O2 and H3G or Vodafone, or on O2's ability to avoid flip-flopping charges in October 2010, and we do not consider that we need to address this issue further.

Conclusions

- 4.46 We have considered the representations we received on the Draft Determination, and have addressed above the points raised. For the reasons set out above, we do not consider that those representations mean that we should alter the draft conclusions that we set out at paragraphs 3.39 to 3.40 above, and we therefore adopt those as our final conclusions. Our determination giving effect to our final conclusions is set out at Annex 1.

Determination to resolve a dispute between O2 and each of Vodafone and H3G about wholesale voice call termination charges in October 2010

Annex 1

The Determination

Dispute between O2 and each of Vodafone and H3G

Determination under sections 188 and 190 of the Communications Act 2003 (“Act”) for resolving a dispute between Telefónica O2 UK Limited (“O2”) and each of Vodafone Ltd (“Vodafone”) and 3G UK Ltd (“H3G”) concerning wholesale voice call termination charges in October 2010

WHEREAS—

(A) section 188(2) of the Act provides that, where Ofcom has decided pursuant to section 186(2) of the Act that it is appropriate for it to handle the dispute, Ofcom must consider the dispute and make a determination for resolving it. The determination that Ofcom makes for resolving the dispute must be notified to the parties in accordance with section 188(7) of the Act, together with a full statement of the reasons on which the determination is based, and publish so much of its determination as (having regard, in particular, to the need to preserve commercial confidentiality) they consider appropriate to publish for bringing it to the attention of the members of the public, including to the extent that Ofcom considers pursuant to section 393(2)(a) of the Act that any such disclosure is made for the purpose of facilitating the carrying out by Ofcom of any of its functions;

(B) section 190 of the Act sets out the scope of Ofcom’s powers in resolving a dispute which may, in accordance with section 190(2) of the Act, include—

- making a declaration setting out the rights and obligations of the parties to the dispute;
- giving a direction fixing the terms or conditions of transactions between the parties to the dispute;
- giving a direction imposing an obligation, enforceable by the parties to the dispute, to enter into a transaction between themselves on the terms and conditions fixed by Ofcom; and
- for the purpose of giving effect to a determination by Ofcom of the proper amount of a charge in respect of which amounts have been paid by one of the parties to the dispute to the other, giving a direction, enforceable by the party to whom sums are to be paid, requiring the payment of sums by way of adjustment of an underpayment or overpayment;

(C) on 12 April 2011, O2 submitted a dispute with each of Vodafone and H3G to Ofcom for resolution, alleging that it was not fair and reasonable for each of Vodafone and H3G to levy the charges which applied to the purchase of wholesale voice call termination services by O2 during the period October 2010;

(D) on 16 May 2011, Ofcom decided that it was appropriate for it to handle this dispute and set the scope of the issues to be resolved in the dispute as follows:

Determination to resolve a dispute between O2 and each of Vodafone and H3G about wholesale voice call termination charges in October 2010

- (i) *whether it was fair and reasonable in light of the prevailing regulatory regime for Vodafone and H3G to levy the charges which applied to the purchase of wholesale voice call termination services by O2 during the period October 2010; and*
- (ii) *if not, what charges would it have been fair and reasonable for Vodafone and H3G to have levied on O2 for the purchase of wholesale voice call termination services during the period October 2010?”*

(E) a non-confidential draft determination was sent to the parties on 4 August 2011 and published on Ofcom’s website on 5 August 2011;

(F) in order to resolve this dispute, Ofcom has considered (among other things) the information provided by the parties and Ofcom has further acted in accordance with its general duties set out in section 3 of, and the six Community requirements set out in section 4 of the Act; and

(G) a fuller explanation of the background to the dispute and Ofcom’s reasons for making this Determination is set out in the explanatory statement accompanying this Determination.

NOW, therefore, Ofcom makes, for the reasons set out in the accompanying explanatory statement, this Determination for resolving this dispute—

I Declaration of rights and obligations, etc.

- 1 It is hereby declared that it was fair and reasonable in light of the prevailing regulatory regime for Vodafone and H3G to levy the charges which applied to the purchase of wholesale voice call termination services by O2 during the period October 2010.

II Binding nature and effective date

- 2 This Determination is binding on each of O2, Vodafone and H3G in accordance with section 190(8) of the Act.
- 3 This Determination shall take effect on the day it is published.

III Interpretation

- 4 For the purpose of interpreting this Determination—
- a) headings and titles shall be disregarded; and
 - b) the Interpretation Act 1978 shall apply as if this Determination were an Act of Parliament.
- 5 In this Determination—
- a) “**Act**” means the Communications Act 2003 (c.21);
 - b) “**H3G**” means Hutchison 3G UK Limited whose registered company number is 03885486, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by Section 1159 of the Companies Act 2006;

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- c) **“O2”** means Telefónica O2 UK Limited whose registered company number is 1743099, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by Section 1159 of the Companies Act 2006;
- d) **“Ofcom”** means the Office of Communications;
- e) **“Vodafone”** means Vodafone Group Services Limited whose registered company number is whose registered company number is 3802001, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by Section 1159 of the Companies Act 2006.



Neil Buckley

Director of Investigations

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

14 September 2011

Determination to resolve a dispute between O2 and each of Vodafone and H3G about wholesale voice call termination charges in October 2010

Annex 2

SMP Conditions

The SMP services conditions imposed on H3G, O2, Orange, T-Mobile and Vodafone under sections 45, 87 and 88 of the Act as a result of the analysis of the market set out in this Notification, (“SMP conditions”)

Part 1: Application, definitions and interpretation of these conditions

1. The SMP conditions in Part 2 of this Schedule shall, except insofar as it is otherwise stated therein, apply to the markets set out in paragraphs 2 (a) to (e) above of this Notification.

2. In this Schedule:

“2G Public Electronic Communications Network” means a mobile Public Electronic Communications Network which operates using spectrum within the bands 880 to 915 MHz, 925 to 960 MHz, 1710 to 1785 MHz, or 1805 to 1880 MHz;

“2G Call” means a circuit switched conveyance of a speech teleservice only (as defined in the relevant standards of the European Telecommunications Standards Institute) which:

- (i) originates in a Public Electronic Communications Network (whether fixed or mobile);
- (ii) is conveyed via the gateway mobile service switching centre of the Dominant Provider and the 2G Public Electronic Communications Network of another Communications Provider (the “2G Provider”);
- (iii) is terminated using the GSM air interface of the 2G Provider, or by agreement, of another Communications Provider; and
- (iv) terminates on a GSM mobile handset of a Customer of the Dominant Provider.

For the purposes of this definition:

(a) “the relevant standards of the European Telecommunications Standards Institute” means the European Telecommunications Standard (ETS) of ETS 300 905 (GSM 02.03 version 5.3.2), Third Edition, January 1998, which has been produced by the Special Mobile Group of the European Telecommunications Standards Institute; and

(b) “GSM” means the Global System for Mobile communications, as defined in the relevant standards of the European Telecommunications Standards Institute;

“3G Public Electronic Communications Network” means a mobile Public Electronic Communications Network which operates using spectrum within the bands 1900 -1980 MHz or 2110 -2170 MHz;

“3G Call” means a circuit switched conveyance of a speech teleservice only (as defined in the relevant standards of the 3rd Generation Partnership Project) originating in a Public Electronic Communications Network (whether fixed or mobile) and which terminates on a

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mobile handset which is connected to the 3G Public Electronic Communications Network of the Dominant Provider.

For the purposes of this definition “the relevant standards of the 3rd Generation Partnership Project” means the following standards of the 3rd Generation Partnership Project-

(a) 3G TS 22.001 V3.2.0 (2000-03) (Technical Specification: Digital cellular telecommunications system (Phase 2+), Technical Specification Group Services and System Aspects, and Principles of circuit telecommunication services supported by a Public Land Mobile Network (PLMN)) (Release 1999);

(b) 3GPP TS 22.002 V3.6.0 (2001-03) (Technical Specification: Technical Specification Group Services and System Aspects, and Circuit Bearer Services (BS) supported by a Public Land Mobile Network (PLMN)) (Release 1999);

(c) 3G TS 22.003 V3.3.0 (2000-06) (Technical Specification: Technical Specification Group Services and System Aspects, and Circuit Teleservices supported by a Public Land Mobile Network (PLMN)) (Release 1999); and

(d) 3GPP TS 22.101 V 3.17.0 (2004-03) (Technical Specification: Technical Specification Group Services and System Aspects, Service aspects and Service principles) (Release 1999);

"Access Charge Change Notice" has the meaning given to it in Condition MA5.4;

"Access Contract" means a contract for the provision of Network Access;

"Act" means the Communications Act 2003;

'Base Year' means for each Relevant Year, the period of 12 months ending on 31 March immediately preceding that Relevant Year

"Call" means either a 2G Call or a 3G Call;

"Controlling Percentage" means, in relation to the Second Relevant Year, the amount of change in the Retail Prices Index in the period of 12 months ending on the 31 December immediately before the beginning of that Relevant Year, expressed as a percentage (rounded to one decimal place) of that Retail Prices Index as at the beginning of that period reduced by:

(a) 15.1% for H3G;

(b) 3.2% for O2;

(c) 5.8% for Orange;

(d) 5.8% for T-Mobile; and

(e) 3.2% for Vodafone;

and, in relation to the Third and Fourth Relevant Year, the amount of change in the Retail Prices Index in the period of 12 months ending on the 31 December immediately before the

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beginning of that Relevant Year, expressed as a percentage (rounded to one decimal place) of that Retail Prices Index as at the beginning of that period reduced by:

- (a) 11.8% for H3G;
- (b) 2.5% for O2;
- (c) 5.3% for Orange;
- (d) 5.3% for T-Mobile; and
- (e) 2.5% for Vodafone;

“Charging Period” means any of the current charging periods published by the Dominant Provider;

“Director” means the Director-General of Telecommunications as appointed under section 1 of the Telecommunications Act 1984;

“Dominant Provider” means H3G, O2, Orange, T-Mobile and Vodafone;

“Fixed-to-Mobile Call” means a Call originating in a fixed Public Electronic Communications Network which is terminated on the Dominant Provider’s network and where the Dominant Provider sets the charge;

“Fixed-to-Mobile Interconnection Charge” means the charge for Calls made by the Dominant Provider for the Interconnection of a Fixed-to-Mobile Call, excluding any discounts offered by the Dominant Provider, whether in respect of any particular Customer or any category of Customers or any category of Calls;

“Functional Specification” shall have the same meaning as in Condition 18 of the General Conditions of Entitlement or its equivalent;

“General Conditions of Entitlement” means those general conditions set by the Director by way of publication of a Notification under section 48(1) of the Act on 22 July 2003, or its equivalent;

“H3G” means Hutchison 3G UK Limited whose registered company number is 3885486 and any Hutchison 3G (UK) Limited subsidiary or holding company, or any subsidiary of that holding company, all as defined by section 736 of the Companies Act 1985 as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act);

“Mobile-to-Mobile Call” means a Call originating in a mobile Public Electronic Communications Network of another Communications Provider which is terminated on the Dominant Provider’s network and where the Dominant Provider sets the charge;

“Mobile-to-Mobile Interconnection Charge” means the charge for Calls made by the Dominant Provider for the Interconnection of a Mobile-to-Mobile Call, excluding any discounts offered by the Dominant Provider, whether in respect of any particular Customer or any category of Customers or any category of Calls;

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“Network Access” means the provision of Interconnection to the Public Electronic Communications Network provided by the Dominant Provider, together with any services, facilities or arrangements which are necessary for the provision of Electronic Communications Services over that Interconnection;

“O2” means O2 (UK) Limited, whose registered company number is 1743099 and any O2 (UK) Limited subsidiary or holding company, or any subsidiary of that holding company, all as defined by section 736 of the Companies Act 1985 as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act);

“Ofcom” means the Office of Communications;

“Orange” means Orange Personal Communications Services Limited, whose registered company number is 2178917 and any Orange Personal Communications Services Limited subsidiary or holding company of the companies listed in (a) to (b) above, or any subsidiary of that holding company, all as defined by section 736 of the Companies Act 1985 as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act);

‘Relevant Year’ means any of the following:

(i) the period of 12 months beginning on 1 April 2007 and ending on 31 March 2008 (the “First Relevant Year”);

(ii) the period of 12 months beginning on 1 April 2008 and ending on 31 March 2009 (the “Second Relevant Year”);

(iii) the period of 12 months beginning on 1 April 2009 and ending on 31 March 2010 (the “Third Relevant Year”); and

(iv) the period of 12 months beginning on 1 April 2010 and ending on 31 March 2011 (the “Fourth Relevant Year”);

“Retail Prices Index” means the index of retail prices compiled by an agency or a public body on behalf of Her Majesty’s Government or a governmental department from time to time in respect of all items (which is the Office for National Statistics at the time of publication of this Notification);

“Subscriber Number” shall have the same meaning as in the Functional Specification;

“T- Mobile” means T-Mobile (UK) Limited, whose registered company number is 2382161; and any T-Mobile (UK) Limited subsidiary or holding company, or any subsidiary of that holding company, all as defined by section 736 of the Companies Act 1985 as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act);

“Third Party” means a person providing a Public Electronic Communications Network; and,

“Vodafone” means Vodafone Limited, whose registered company number is 1471587; and any Vodafone Limited subsidiary or holding company, or any subsidiary of that holding company, all as defined by section 736 of the Companies Act 1985 as amended by the Companies Act 1989 (or any subsequent amendment or replacement Act).

3. For the purpose of interpreting the SMP conditions in Part 2 of this Schedule:

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(a) except insofar as the context otherwise requires, words or expressions shall have the meaning ascribed to them in paragraph 2 above and otherwise any word or expression shall have the same meaning as it has in the Act;

(b) the Interpretation Act 1978 shall apply as if each of the SMP conditions were an Act of Parliament; and

(c) headings and titles shall be disregarded.

Part 2: The SMP conditions

Condition MA1 – Requirement to provide network access on reasonable request

MA1.1 Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access. The Dominant Provider shall also provide such Network Access as Ofcom may from time to time direct.

MA1.2 Subject to condition MA1.3, the provision of Network Access in accordance with paragraph MA1.1 shall occur as soon as reasonably practicable and shall be provided on fair and reasonable terms and conditions (including charges) and on such terms and conditions (including charges) as Ofcom may from time to time direct.

MA1.3 The charges for Calls as covered by SMP conditions MA3 and MA4 below shall be as set out in those conditions, but only for the duration of those conditions²⁹.

MA1.4 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition.

Condition MA2 – Requirement not to unduly discriminate

MA2.1 The Dominant Provider shall not unduly discriminate against particular persons or against a particular description of persons, in relation to matters connected with Network Access.

Condition MA3 – Control of Fixed-to-Mobile Interconnection Charges

MA3.1 Except in so far as Ofcom may otherwise consent under paragraph MA3.7 below, the Dominant Provider shall take all reasonable steps to secure that, during any Relevant Year, the Average Interconnection Charge does not exceed the Target Average Charge for the provision of Network Access.

MA3.2 In this Condition, the Average Interconnection Charge means the average of the Fixed-to-Mobile Interconnection Charges during the Relevant Year in question, which shall be weighted according to:

(a) the profile by Charging Period of the Dominant Provider's sum of minutes of Fixed-to-Mobile Calls and Mobile-to-Mobile Calls; and

(b) the corresponding volumes by month or part-month of the Dominant Provider's sum of minutes of Fixed-to-Mobile Calls and Mobile-to-Mobile Calls, in the Base Year.

²⁹ SMP Condition MA3 sets fixed-to-mobile interconnection charges and is therefore not relevant to this Dispute.

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MA3.3 For the purposes of calculating the Average Interconnection Charge where any Fixed-to-Mobile Interconnection Charges are in force during a part only of the Relevant Year (commencing or ending at a date in the course of the Relevant Year), the weighting shall be derived from:

a) the profile by Charging Period of the Dominant Provider's sum of minutes of Fixed-to-Mobile Calls and Mobile-to-Mobile Calls; and

(b) the corresponding volumes by month or part-month of the Dominant Provider's sum of minutes of Fixed-to-Mobile Calls and Mobile-to-Mobile Calls,

in the corresponding part of the Base Year.

MA3.4 For the purposes of this Condition, the Target Average Charge means:

(a) for the purpose of the First Relevant Year

(i) 9.1 pence per minute for H3G;

(ii) 5.7 pence per minute for O2;

(iii) 6.2 pence per minute for Orange;

(iv) 6.2 pence per minute for T-Mobile; and

(v) 5.7 pence per minute for Vodafone;

(b) for the purpose of the Second, Third and Fourth Relevant Years:

the Target Average Charge in the Base Year multiplied by the sum of 100% and the Controlling Percentage for that Relevant Year.

MA3.5 The Dominant Provider shall not make any Fixed-to-Mobile Interconnection Charge for:

(a) a Fixed-to-Mobile Call which terminates on a recorded announcement provided by the Dominant Provider informing the caller of an inability to complete that call so as to establish a two-way path where the mobile handset used by the called party is switched off, or rings and remains unanswered, or where coverage is not available from the Dominant Provider's Public Electronic Communications Network; and

(b) an unanswered Fixed-to-Mobile Call which is diverted in respect of the period before that call is answered.

MA3.6 Notwithstanding (and without prejudice to the generality of) the obligation imposed on the Dominant Provider by SMP condition MA3.1 above:

(a) if the Dominant Provider has failed to secure that the Average Interconnection Charge has not exceeded the Target Average Charge for the First, Second or Third Relevant Year, the Dominant Provider shall make such adjustments to its Fixed-to-Mobile Interconnection Charges and by such day in the following Relevant Year as Ofcom may direct for the purpose of remedying that failure. Such adjustments in the Second, Third or Fourth Relevant

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Year shall not be relevant for the purpose of establishing compliance with SMP condition MA3.1 above in that Relevant Year; and

(b) if it appears to Ofcom that the Dominant Provider is likely to fail to secure that the Average Interconnection Charge for the Fourth Relevant Year does not exceed the Target Average Charge for that Year, the Dominant Provider shall make such adjustments to its Fixed-to-Mobile Interconnection Charges and by such day in that year as Ofcom may direct for the purpose of avoiding that failure.

MA3.7 Where the Average Interconnection Charge is less than the Target Average Charge for the First, Second or Third Relevant Year, the Dominant Provider shall not make such adjustments to its Fixed-to-Mobile Interconnection Charges in the following Relevant Year to recover the difference between the Average Interconnection Charge and the Target Average Charge for the First, Second or Third Relevant Year, unless Ofcom have given their prior written consent to such adjustments. Such adjustments in the Second, Third or Fourth Relevant Year shall not be relevant for the purpose of establishing compliance with SMP condition MA3.1 in that Relevant Year.

MA3.8 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition.

MA3.9 In this Condition:

‘**Average Interconnection Charge**’ has the meaning given to it in SMP condition MA3.2; and

‘**Target Average Charge**’ shall have the meaning given to it in SMP condition MA3.4;

Condition MA4 – Control of Mobile to Mobile Interconnection Charges

MA4.1 Except in so far as Ofcom may otherwise consent under SMP condition MA4.7 below, the Dominant Provider shall take all reasonable steps to secure that, during any Relevant Year, the Average Interconnection Charge does not exceed the Target Average Charge for the provision of Network Access.

MA4.2 In this Condition, the Average Interconnection Charge means the average of the Mobile-to-Mobile Interconnection Charges during the Relevant Year in question, which shall be weighted according to:

- (a) the profile by Charging Period of the Dominant Provider’s sum of minutes of Fixed-to-Mobile Calls and Mobile-to-Mobile Calls; and
- (b) the corresponding volumes by month or part-month of the Dominant Provider’s sum of minutes of Fixed-to-Mobile Calls and Mobile-to-Mobile Calls, in the Base Year.

MA4.3 For the purposes of calculating the Average Interconnection Charge where any Mobile-to-Mobile Interconnection Charges are in force during a part only of the Relevant Year (commencing or ending at a date in the course of the Relevant Year), the weighting shall be derived from:

- (a) the profile by Charging Period of the Dominant Provider’s sum of minutes of Fixed-to-Mobile Calls and Mobile-to-Mobile Calls; and

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- (b) the corresponding volumes by month or part-month of the Dominant Provider's sum of minutes of Fixed-to-Mobile Calls and Mobile-to-Mobile Calls, in the corresponding part of the Base Year.

MA4.4 For the purposes of this Condition, the Target Average Charge means:

- (a) for the purpose of the First Relevant Year

- (i) 9.1 pence per minute for H3G;
- (ii) 5.7 pence per minute for O2;
- (iii) 6.2 pence per minute for Orange;
- (iv) 6.2 pence per minute for T-Mobile; and
- (v) 5.7 pence per minute for Vodafone;

- (b) for the purpose of the Second, Third and Fourth Relevant Years:

the Target Average Charge in the Base Year multiplied by the sum of 100% and the Controlling Percentage for that Relevant Year.

MA4.5 The Dominant Provider shall not make any Mobile-to-Mobile Interconnection Charge for:

- (a) a Mobile-to-Mobile Call which terminates on a recorded announcement provided by the Dominant Provider informing the caller of an inability to complete that call so as to establish a two-way path where the mobile handset used by the called party is switched off, or rings and remains unanswered, or where coverage is not available from the Dominant Provider's Public Electronic Communications Network; and
- (b) an unanswered Mobile-to-Mobile Call which is diverted in respect of the period before that call is answered.

MA4.6 Notwithstanding (and without prejudice to the generality of) the obligation imposed on the Dominant Provider by SMP condition MA4.1 above:

- (a) if the Dominant Provider has failed to secure that the Average Interconnection Charge has not exceeded the Target Average Charge for the First, Second or Third Relevant Year, the Dominant Provider shall make such adjustments to its Mobile-to-Mobile Interconnection Charges and by such day in the following Relevant Year as Ofcom may direct for the purpose of remedying that failure. Such adjustments in the Second, Third or Fourth Relevant Year shall not be relevant for the purpose of establishing compliance with SMP condition MA4.1 above in that Relevant Year; and
- (b) if it appears to Ofcom that the Dominant Provider is likely to fail to secure that the Average Interconnection Charge for the Fourth Relevant Year does not exceed the Target Average Charge for that Year, the Dominant Provider shall make such adjustments to its Mobile-to-Mobile Interconnection Charges and by such day in that Year as Ofcom may direct for the purpose of avoiding that failure.

MA4.7 Where the Average Interconnection Charge is less than the Target Average Charge for the First, Second or Third Relevant Year, the Dominant Provider shall not make such adjustments to its Mobile-to-Mobile Interconnection Charges in the following Relevant Year to recover the difference between the Average Interconnection Charge and the Target

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Average Charge for the First, Second or Third Relevant Year, unless Ofcom have given their prior written consent to such adjustments. Such adjustments in the Second, Third or Fourth Relevant Year shall not be relevant for the purpose of establishing compliance with SMP condition MA4.1 in that Relevant Year.

MA4.8 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition.

MA4.9 In this Condition:

‘**Average Interconnection Charge**’ has the meaning given to it in SMP condition MA4.2; and

‘**Target Average Charge**’ shall have the meaning given to it in SMP condition MA4.4.

Condition MA5 – Requirement to publish charges

MA5.1 Except in so far as Ofcom may otherwise consent in writing, the Dominant Provider shall publish its charges for the provision of Network Access and act in the manner set out below.

MA5.2 The Dominant Provider shall publish its charges for terminating a Call, separately from any of its other termination charges.

MA5.3 The Dominant Provider shall, within 28 days of the date that this Condition comes into force, publish its charges on which it provides Network Access.

MA5.4 The Dominant Provider shall publish any amendment to the charges on which it provides Network Access or in relation to any charges for new Network Access (an "Access Charge Change Notice") not less than 28 days before any such amendment or new charge comes into effect.

MA5.5 Publication of the information in conditions MA5.3 and MA5.4 shall be effected by:

(a) sending a copy of such information or any appropriate parts of it to any person who may reasonably request such a copy; and

(b) placing a copy of such information on any relevant website operated or controlled by the Dominant Provider.

MA5.6 The Dominant Provider shall ensure that an Access Charge Change Notice includes:

- a. a description of, and the proposed new charge for the Network Access in question;
- b. where applicable, the current charge for the Network Access in question; and
- c. the date on which or the period for which any amendments to charges will take effect (the "effective date").

MA5.7 The Dominant Provider shall not apply any new charge identified in an Access Charge Change Notice before the effective date.