

*Representing the Communication Services Industry*



## **Mobile citizens, mobile consumers**

**FCS response to**

**The Ofcom consultation  
Issued on 28 August 2008**

FCS Contact:  
Jacqui Brookes OBE  
CEO  
FCS  
Burnhill Business Centre  
Burrell Row  
Beckenham  
Kent BR3 1AT

[www.fcs.org.uk](http://www.fcs.org.uk)

## Contents

Page

**Summary**  
3

**1 Introduction**  
4

**2 Mobile market**  
5

**Major issues for FCS members:**

- 3 FCS member survey  
6
- 4 Mobile new entrants  
6
- 5 Mobile number portability  
6
- 6 Closure of mobile number ranges  
7
- 7 Fixed mobile convergence  
8
- 8 Tariff transparency  
8
- 9 SMS  
8

**10 History**  
9

**11 Conclusion**  
9

**Answers to the consultation document questions**  
10

**Appendices:**

**1 FCS mobile market opinion survey- 2008: Summary report**  
15

**2 SMS issues**  
17

**3 FCS response to Oftel's 2001 mobile market review- separate document**

## **Mobile Sector Assessment- FCS response**

### **Summary**

In a period of economic downturn the telecoms sector as a whole and the mobile market in particular is able to deliver essential support for the economy. With demand for greater efficiencies and lower cost solutions by customers, Ofcom has a central role to play and targeted regulation rather than a “light touch” will provide the solution.

As the UK moves forward into an effective converged fixed and mobile telecoms market the FCS believes that Ofcom has to act on deficiencies in the mobile market that have lain untouched for some time. FCS members report that the mobile market is not sustainably competitive within the distribution chain and these areas require Ofcom’s attention.

In this response we have identified several areas of concern associated with

- 10 Mobile new entrants
- 11 Mobile number portability
- 12 Closure of mobile number ranges
- 13 Fixed mobile convergence
- 14 Tariff transparency
- 15 SMS

FCS supports many of the outcomes that Ofcom is seeking in this review.

We view the optimum market as one that has a multiplicity of suppliers down the distribution chain and where there is a bottleneck, such as the obvious limitation in national infrastructure, wholesale access on fair and equitable terms should be obligated. At the same time mobile new entrants need specific support to enter the market such as recipient led mobile number portability and direct routing of ported numbers. This will lead to a wider choice of suppliers, who require a sustained fair and competitive regulatory environment to deliver services.

We specifically seek a wholesale SMS review and an urgent cross industry/ regulator/ consumer project on tariff transparency.

## 1 Introduction

The Federation of Communication Services [FCS] is the UK Trade Association for the communications services industry representing suppliers of products and services delivered by mobile, fixed, IP, wireless and other modes. More information on the FCS and a directory of our company members may be found on the website [www.fcs.org.uk](http://www.fcs.org.uk)

The FCS is pleased to have the opportunity to respond to the carefully thought out Mobile Sector Assessment [MSA] consultation that focuses on adapting regulation for a mobile and wireless world.

The FCS members that are specifically affected by mobile regulation as market participants include:

- New entrant mobile operators
- Mobile equipment manufacturers
- Service Providers
- Resellers
- Dealers and retailers

The customers served by our members- the Mobile Market- include UK business and the economy as well as individual consumers. Our response assumes that Ofcom agrees that the terms "Mobile citizens" and "Mobile consumers" include the corporate and enterprise sector.

A helicopter view of the UK with 5 competing vertically integrated mobile operators dominating the mobile market may seem like a "paradise of competition" but such a superficial view belies problems in the market leading to our view that there is consumer and business deficit in the UK that regulation needs to act upon.

Looking forward, we predict that all customers will seek new services and innovation. In a period of economic slowdown and beyond both the public and enterprise sectors will demand improved efficiency and reducing costs. Telecoms particularly mobile services enhance business efficiency and are drivers for the economy as a whole. However cost reduction driven by sustainable competition is a function of the retail market, which we believe requires more regulatory scrutiny.

The undoubted economic downturn has implications for the telecoms sector and its customers; in a recently published view Andrew Parkin-White, Practice Leader at Analysys Mason <http://www.analysismason.com/> says:

*One key area of focus for telcos is cost control; they clearly want to conserve cash at present, either to build up reserves or to service existing debt. Companies that have taken on heavy debt burdens as a result of marked expansion in recent times are finding their survival under serious threat in the current economic situation. Plainly, telcos will be curbing supply-side investments in favour of a more measured investment approach and cost control. Smaller players that are unable to make economies of scale will be unlikely to continue building access networks with duplicate footprints. Investments in next-generation access networks and evolutionary mobile technologies will be more disciplined. Similarly, as in other sectors of the economy, M&A activity will be more selective.*

*The demand side is more difficult to predict, as telecoms services have never previously been tested in a downturn. The market has changed beyond all recognition since the last recession, in the early 1990s. At that time, mobile was a minority service and POTS was standard on the fixed side. Spend on telecoms, as a share of GDP, demonstrates a relatively consistent downward trend. Given falling GDP, increasing inflation, a shrinking enterprise sector and fear and uncertainty in the consumer market, end-user demand will suffer. The extent to which revenue will fall is more difficult to forecast at present. It is likely to be several months before real market behaviour confirms the level of the downward trend in spend.*

In this response we address major issues affecting the market in our comments and in answers to the consultation questions. They include:

- 16 FCS member survey
- 17 Mobile new entrants
- 18 Mobile number portability
- 19 Closure of mobile number ranges
- 20 Fixed mobile convergence
- 21 Tariff transparency
- 22 SMS

## **2 Mobile Market**

When Ofcom reviewed the telecommunications market in 2004-5 it set aside the problems with the mobile market and concentrated on the fixed telephony sector and the dominance of BT. The review resulted in the BT Undertakings and the establishment of Openreach delivering equivalence products

The BT Undertakings have opened up the fixed line sector to competition, not only to a few selected alternative operators, but to a thriving and evolving competitive Communications Provider [CP] sector that is delivering broadband, WLR, VoIP and multiple other services. Openreach now has over 400 CP customers.

But access to mobile services by the same CPs is restricted and the strong question remains - why cannot functional separation be extended to large mobile incumbents?

Customers, particularly business customers, who demand the level of customer care provided by independent fixed line providers, are unable to access the same level of support with a single bill for fixed, broadband and mobile since their suppliers cannot offer the mobile service element. Resellers report that wholesale mobile offerings are not competitive compared to the direct sales of the incumbents. The dealer community cites similar undercutting by the direct arm of their suppliers

An opinion survey of FCS members in Appendix 1 demonstrates these concerns in more detail and a specific case study by reseller the Phone Co-op was presented at the FCS Comms Provider 08 event [see [www.fcs.org.uk](http://www.fcs.org.uk)]. The Phone Co-op provides community services to its members but whereas fixed line telephony is accessible at reasonable rates, no suitable mobile reseller deals have been available. This example illustrates one of the problems with the market and lack of access for customers to such new services particularly for community mobile.

Access to radio spectrum is limited. Planning permission in the densely populated UK islands and public wariness restrict expansion of radio infrastructure and so without a regulatory remedy competitive access to mobile markets for retail competition faces significant hurdles. New entrant operators face significant barriers and require regulatory support to enter the market

Ofcom's strategy in telecommunications is to promote competition at the deepest level of infrastructure that is effective and sustainable, but as new infrastructure is limited [there have been 5 national GSM/3G mobile operators for 6-7 years, the sole national public access radio service ceased on 2001 and mobile new entrants are facing market entry barriers], the deepest level of infrastructure for mobile is probably at the wholesale level and there Ofcom needs to apply regulation.

There is a level of competition in the residential or individual consumer market, but this is based on a long established model of handset subsidy that does not easily enable other competitive models to enter the UK market.

### **3 FCS member survey**

During 2008 FCS conducted opinion surveys among its diverse membership, which is summarised in Appendix 1

The overriding concerns raised by industry players, that impact their customers, are:

- the lack of a level playing field between independent suppliers and the direct arms of vertically integrated mobile operators; connections via third parties take longer than direct sales;
- in an environment of growing fixed mobile convergence resellers in the fixed sector are unable to access mobile services on suitable terms;
- the inability of finding an operator willing to permit wholesale access so that a reseller can add operator minutes to their bill;
- contract terms are getting longer, tying in some customers for 18-24 months and inhibiting customer transfer to an alternative supplier;
- customers are not getting a good deal since there is not a fair playing field between direct sales and independent suppliers- the impact of vertical integration is to reduce choice for the consumer;
- there is not sufficient competition in the retail mobile market as 3<sup>rd</sup> party providers are frozen out; and
- the solution is to ensure equal access to all CPs as provided by Openreach

The overall opinion arising from the survey is that there are barriers at the retail level and that wholesale access is almost impossible to achieve except for a few large MVNOs, unlike the fixed and IP sector. FCS members conclude that the barriers arise from the nature of vertical integration and the limited numbers of mobile operators, which only the regulator can address.

### **4 Mobile new entrants**

New entrant mobile operators have been encouraged to enter the mobile market by Ofcom and radio spectrum auctions have been designed to release blocks of spectrum to entice new names into the marketplace. But, as Ofcom acknowledges in the consultation, new entrants have had a difficult time in the UK. Elsewhere in Europe market entry is speedier and other Europeans are benefiting from the new services provided. Inward investors to the UK report that the lack of mobile number portability [mnp] as a deterrent and have set up services in other Member States in preference where recipient led mobile porting is available and market entry welcomed.

The DECT guard band licensees are one example of mobile new entrants. Ofcom auctioned the spectrum [1781.7-1785 MHz paired with 1876.7- 1880 MHz] in May 2006 to 12 licensees permitting concurrent access for low power services. But market entry by the 11 non incumbents has been thwarted because of the barrier of mobile number portability, an obligation regulated by Ofcom itself. No wonder Ofcom is unable to report success in section 3.94 of the consultation.

There are implications for the value of auctioned spectrum suitable for commercial services if the spectrum winners face major regulatory hurdles, which are also the responsibility of Ofcom, in building their businesses

### **5 Mobile number portability**

The existing mnp processes are owned by the 5 mobile operators [MNOs]. In 2007 FCS welcomed Ofcom's initial stance in addressing the incumbent MNOs' restriction of access to mobile number porting by new entrant operators. But after 20 months of round table meetings chaired by Ofcom, none of the new entrants has yet reported the ability to port a mobile number with all incumbents. Compliance with GC 18 is proving difficult.

The current mnp process is donor led. Any new entrant is required to be accepted by the Operators Steering Group, to set up commercial bilateral contracts with each of the other operators and undergo bilateral testing. FCS has assisted where it can to support the OSG, which is an unincorporated body.

Commercial arrangements between large incumbents and small new entrants have raised new issues for resolution and Ofcom cannot intervene unless a dispute is raised- adding further time delay. The cumulative effect of this complex process is to slow down entry by new entrants. Consumer detriment follows when new and innovative services cannot be brought to market.

Ofcom had proposed the establishment of a Central Data Base of ported numbers and recipient led mobile porting which was due to be in place by September 2009, referred to in Section 6.18 of the consultation. This arrangement would have brought the UK up to date with number portability processes that are well established in Europe and Australia. But, following the Vodafone's successful appeal to the Competition Appeal Tribunal on 18 September 2008 that opportunity has also receded as co-operative work under the industry body UK Porting- [www.ukporting.org.uk](http://www.ukporting.org.uk) - has now ceased.

## 6 Closure of number ranges

In August and September 2007 two mobile operators cut off the mobile number ranges of new entrants operators without warning, preventing new entrants from commencing service. Reasons cited included unsatisfactory new entrant termination costs.

FCS members commented that an incumbent can wield immense power through being able to withhold the building of numbering or even un-build numbering. Take an example of an incumbent MNO with 15 million subscribers and a new entrant with 25,000 subscribers. While over 99.8% of the incumbents customers may not care that they can not reach the new entrant's subscribers, it will certainly be the case that approaching 100% of the new entrant's customers will care that they can't be called by subscribers of the MNO.

This action can take place as there is no regulation of end-to-end connection requirement for mobile operators, yet because of their size they appear to have countervailing market power.

This has very serious implications. Unless Ofcom acts on this matter, then any OCP is free to disconnect any Terminating CP service [competing or otherwise] without due notice or reasonable negotiation. It is therefore probable that small businesses in this market are now at severe risk of being cut-off without notice from all except BT, on which a clear end to end obligation has been placed.

[http://www.ofcom.org.uk/consult/condocs/end\\_to\\_end/statement/](http://www.ofcom.org.uk/consult/condocs/end_to_end/statement/)

It is interesting to note that in the above Statement of September 2006, Ofcom sets an important caveat:

*"4.3 In setting this condition, Ofcom considers it is necessary to ensure end-to-end connectivity is available in the UK. As set out in the July consultation, in Ofcom's view it is sufficient and proportionate to do so by imposing an obligation on BT only. Ofcom believes that other PECNs will have a commercial incentive to provide end-to-end connectivity to their customers that should be sufficiently strong to ensure that they seek to purchase call termination and that no additional ex ante regulation is required. However, Ofcom would examine the case for proposing ex ante conditions on other PECNs should they not provide end-to-end connectivity."*

Clearly Ofcom's belief that "no additional ex ante regulation is required" has been superseded by events and Ofcom should look to strengthening of the end to end obligation. Otherwise companies will be very wary of the risk of launching their mobile services in the UK.

This means that, without price regulation, mobile originated international calls and roaming charges could “remain excessive for the foreseeable future”, to the detriment of the UK/EU consumers and businesses.

## **7 Fixed mobile convergence**

The consultation recognises that Fixed Mobile Convergence [FMC] is inevitable. But to be effective FMC requires network neutrality, transparent customer migration and numbers that are not linked to a particular service. This suggests for example that 07 numbers would no longer be referred to as “mobile numbers”. New FMC services can offer a single number to a customer that can be used on a mobile, a VoIP phone or a home DECT phone with controlled costs. We believe that demand for cost reduction by customers will be a strong driver in this time of economic slowdown

Conditions for the success of FMC include:

- The provision of Mobile broadband, VoIP and hosted services by multiple players
- Transparent and seamless customer migration between suppliers
- Tariff /price transparency
- Common portability processes across technologies. FCs encourages Ofcom to reinvigorate its planned number portability policy of recipient led porting with direct routing of numbers via a Central database of all numbers

## **8 Tariff transparency**

Tariff transparency, a facility to advise customers of how much a telephone call will cost, is an example where neither the regulator nor industry alone has been able to reach a satisfactory conclusion, yet our members report this is a gnawing problem that is ripe for action. Ofcom and Phone Pay Plus both report increasing customer complaints about their mobile bills, a result of a lack of price clarity.

The benefits of price transparency are evident and include

- Consumers make informed choices
- Consumers get protection
- Reduction in scams and corporate swindles
- Efficient price competition
- Drives down wholesale termination rates
- Less Intrusive regulation
- More trust in the market

Several solutions have been put forward by the regulator and industry in different fora and each needs to be reviewed under a single project. Number prefix related to price, pre-call announcements, tariff tables, press star followed by the phone number to obtain the call charge- each have been proposed but none yet universally adopted.

Ofcom could direct industry to come forward with reasonable proposals in a set timescale, tested with consumers, using a format such as the OTA and led by an independent chairman. But “Industry” does not imply only the large company players but representatives of smaller players and new entrants as well contributing on an equal footing

The key to successful action is inclusion and transparency across all services, taking into account what current technology can provide. This is a project that crosses technologies but needs to be urgently addressed.

## **9 SMS**

Wholesale SMS is the service necessary to enable delivery of an SMS from the user of one network to another. Purchasers of mobile termination can be fixed and mobile operators, aggregators or intermediaries that bundle customers’ demands for SMS in bulk.

With the growth and variety of use of SMS, market limitations have been revealed and Ofcom proposed to conduct a review of the wholesale SMS market in 2007. However that was shelved due to resource constraints. In our summary of the issues for wholesale SMS- see Appendix 2 we recommend that:

- SMS must not be differentiated from voice within mobile number portability and Ofcom must clearly state its policy and implement where transgressions occur. We also recommend
- Ofcom should review the SMS market as regulation would seem necessary to remove the current market distortion where wholesale SMS is higher than retail pricing; for example the French and Spanish authorities have recently regulated the SMS termination market
- There should be an obligation similar to voice that covers the routing of SMS as this is a barrier to new entrants, e.g. the issues that new entrants have endured as there is currently no such obligation. (Obligation to Buy)
- Ofcom should allocate SMS short codes, in effect increasing competition in this market, as at present only BT can offer multi network short code SMS services.

## 10 History

The mobile market structure today appears remarkably similar to that of the last decade.

FCS Mobile Independent Service Providers submitted a response to the mobile market review carried out by Oftel in 2001. Our response, which is appended in Appendix 3, included an analysis of competition in the mobile sector by Professor Yamey who concluded that with 4 or 5 mobile operators an oligopoly in the market exists and:

- The UK mobile market is not effectively competitive, there is no prospect of effective competition in the two year term of the review and, given the market structure, in the medium term; but does not exclude effective competition arising at some point if retail competition is encouraged. Suggestions are made as to how retail competition can be encouraged through effective regulation;
- The oligopolistic nature of the market, de facto, means that each of the four MNOs has market power. A report on why this is the case is included in the response;
- If Mobile Independent Service Providers had access to unbundled network services at cost based prices they would introduce real competition in prices at the retail level;
- Oftel should be proactive in acting to prevent leverage of market power by MNOs, foreclosure of access and exclusive arrangements; and
- Oftel must be better resourced to remedy breaches of the regulations in a timely way, to minimise damage and prevent unfair first mover advantage being gained particularly in the introduction of new non-voice and other value added services in the future, for example mobile Internet.

The conclusion then was, in order to promote competition, both upstream and downstream, and to serve the interests of consumers, Oftel should establish and maintain conditions of undistorted competition in the service provider market such that MISPs and the service provider outlets of network operators compete on an equal footing

Replace the word Oftel with Ofcom and little has changed in the intervening 7 years- rather than the UK being a place for mobile competition it is becoming a turgid market where incumbents and not regulators appear to frame the rules for competitive entry.

## 11 Conclusion

FCS supports many of the outcomes that Ofcom is seeking in this review, but we view the market as one that has a multiplicity of suppliers down the distribution chain and where there is a bottleneck, such as the obvious limitation in national infrastructure, wholesale access should be obligated. At the same time mobile new entrants need specific support to enter the market. This will lead to a wide choice of suppliers, who require a fair and competitive regulatory environment to deliver services. We specifically seek a wholesale SMS review and

an urgent cross industry/ regulator/ consumer project on tariff transparency. We urge Ofcom to take a holistic view of the whole mobile market, linked to FMC, to help to drive the market forward.

## ***Consultation questions***

### ***Question 1.1: What are the implications of market change for mobile and wireless services?***

The prospect of new entrants across the distribution chain successfully joining the mobile market will introduce new services and competitive offerings to customers. But new operators will require a regulatory “shoe in” to become established as the current regulatory environment enables entrenched patterns of competition to prevail and, as we have described above, creates barriers to market entry.

The move towards fixed mobile convergence, customer demand for greater efficiency and lower costs will combine to reduce the distinction between fixed and mobile services and will require a regulatory envelope that does not give preference to one service over another.

Infrastructure is a national asset.

Regulation should be refocused on wholesale access across the technology platforms- fixed, mobile broadcast- rather than solely on competing infrastructures. Regulation will be needed facilitate ease of customer movement between suppliers and services and that implies active regulation to ensure recipient led number portability supported by direct routing and migration processes.

### ***Question 1.2: How are citizens and consumers affected by developments in the mobile sector?***

Ofcom rightly points out the ubiquity of mobile services and essential role that mobile plays in individual and commercial life in the UK with the potential for widespread new applications in the health and transport sectors, social networking etc. Mobile telephony can enhance public welfare and as such the mobile sector has a social responsibility over and above commercial boundaries.

New developments in the mobile sector can lead to greater efficiency, increased competition and greater coverage, provided the regulatory environment ensures adequate incentives are in place.

### ***Question 1.3: What are the purposes of mobile regulation, and where should its focus lie?***

As noted in the responses above, mobile regulation should facilitate competition along the distribution chain and address the market distortions. The focus should be:

- To assist new operators to enter the market by proactively addressing barriers to market entry in a timely manner such as recipient led mobile number portability
- To ensure wholesale access on fair terms to the incumbent networks
- To promote retail competition
- Promotion of interoperability
- Facilitation of customer migration
- Tariff transparency

### ***Question 1.4: What is the scope for deregulation, competition and innovation in the mobile sector?***

#### ***A4.3 Section 3 – Today’s UK mobile markets***

Regulation in the mobile market is needed to address the issues outlined in the answers to Question 1 above. At some point in the future deregulation might be considered but it is

unlikely to be an option until there is undistorted competition; there has been little change in the past 7 years.

**Question 3.1: What do you think are the features of a well-functioning mobile market? What evidence do you see that those features are present in the UK market?**

The features of a well functioning market include:

- Undistorted competition at the wholesale and retail level for voice, SMS and MMS services
- A range of CPs with different service offerings
- Ease of customer migration across networks
- Price transparency
- Recipient led number portability
- End to end connectivity for SMS and wholesale pricing of SMS
- Robust processes in place to maintain the competitive market
- Consumer protection- firm action on abuses such as slamming

**Question 3.2: What measures are most appropriate to assess whether the mobile sector is performing well for citizens and consumers?**

In relation to our answers to question 3.1

- Access to a range of mobile services from a range of suppliers- large and small
- Fair and undistorted competition between operators and CPs
- Shorter duration contracts
- Ease of switching suppliers
- How easily new entrants can join and continue within the mobile market
- Reduction in consumer complaints

**Question 3.3: How will market dynamics change as a result of trends such as availability of new spectrum, mobile broadband and new ways of delivering voice services?**

- The ability to develop sustainable services using new spectrum allocations will depend on the regulatory framework supporting new entrants otherwise the incumbent MNOs will continue to be dominant suppliers
- That given, the existing services will become substitutable.
- IP based services will make considerable inroads into established mobile services

**A4.4 Section 4 – Consumers**

**Question 4.1: What is your experience, as an individual consumer or an organisation that uses mobile services?**

No comment

**Question 4.2: How should regulators and policy-makers respond to signs of rising consumer concern?**

Identifying nascent consumer problems early is a challenge for regulators and industry alike. Trade Associations like FCS require compliance by our members to existing rules, set by regulators or ourselves, and action is taken based on complaints.

Identifiable consumer concerns should be raised directly with industry itself using rapid communication routes through industry fora and trade bodies as a first step, to scope and analyse the problem. If existing rules or obligations have been broken then appropriate action must be taken following transparent and reasonable processes.

If the consumer concern is new or there are no rules in place the regulator and industry should establish task groups to review, research and propose remedies. The regulator does

not always have all the skills to hand to do this work alone and can be open to appeal on its judgments such as the Vodafone CAT appeal on number portability. That is why industry has to be involved. Some consumer problems are the result of crime or an unclear understanding of the use of telephony. The outcome may be regulation, or codes of practice. Proportionate enforcement is key to maintaining consumer and industry confidence in the market.

The key to successful action is inclusion and transparency across all services- taking into account what current technology can provide

***Question 4.3: What are the important factors to consider in striking a balance between protecting mobile consumers and enabling markets to work flexibly? Have we got this balance right in today's mobile market?***

As we have said earlier, consumer protection will be improved if there is fair and effective competition in the sector with the facility for consumers to move easily to a different supplier. The balance is not right today - Ofcom needs to work to achieve a regulatory regime that delivers sustainable competition.

#### **A4.5 Section 5 - Citizens**

***Question 5.1: How does the use of mobile services affect our participation as citizens in society?***

Improved communication, personal well being and efficiency

***Question 5.2: What factors should we take into account in thinking about access and inclusion issues in mobile markets?***

Ensuring the market is open, competitive and flexible and, where necessary, universal service obligations

***Question 5.3: What factors should we take into account in thinking about new services, and how those services may affect issues like protection of children, privacy and security?***

These issues are wider than the mobile sector alone and should be addressed at a national level

***Question 5.4: Have you been affected by issues about coverage or 'not spots'? How has it affected you?***

No comment

#### **A4.7 Section 7 – Scenarios**

***Question 7.1: What do you see as the most influential trends and features of mobile and wireless markets in future?***

- Convergence of fixed, mobile, broadcast platforms
- Growth in mobile broadband
- Ability to port numbers between mobile, fixed and IP
- Resellers providing converged offerings including mobile to boost the productivity of UK business

***Question 7.2: What new policy and regulatory challenges could the trends identified in this section bring? Which policy and regulatory challenges could they address?***

- Dominance and market power in parts of the value chain are not currently addressed by regulation

- Growing dominance in mobile by organisations dominant in other markets such as fixed, broadcast, base station sites
- Re introducing Ofcom's number portability proposals this time backed with evidence that the national benefit outweighs the costs.

Each area requires regulatory oversight to ensure against abuses of market power

#### **A4.8 Section 8 – Implications**

##### **Question 8.1: Should Ofcom do more to promote competition in mobile and wireless markets?**

Yes as discussed in previous questions:

- Support for new entrant operators
- Wholesale access to networks
- Oversight of retail competition
- Recipient led mnp
- Seamless migration

##### **Question 8.2: Ofcom's strategy in telecommunications is to promote competition at the deepest level of infrastructure that is effective and sustainable. How might this strategy be applied, given future developments in the mobile sector? Under what circumstances, if ever, would it make sense to consider access regulation for mobile platforms?**

Regulation of access to dominant platforms by independent service providers to encourage greater competition among providers and services

##### **Question 8.3: What role can competition play in ensuring that future development of the mobile internet provides an open and flexible environment for a wide range of services? Should Ofcom explore open access requirements to ensure opportunities for innovation? What role might 'net neutrality' play in the mobile sector?**

Yes we support the view that open access will ensure rapid introduction of competing services

Net neutrality is important to ensure a level playing field for new entrants and freedom of choice for the consumer. Individual consumers and the enterprise sector require service to enhance their own well being or business efficiency; they expect effective supply without involvement in the intricacies of the technology or platform delivered to them. FCS members require access to all platforms in order to deliver services to customers and add their own innovative products.

##### **Question 8.4: What role might competition play in addressing questions about transparency of prices, services and contractual conditions offered to consumers of mobile and wireless services? What role should regulation play in addressing these questions?**

A competitive market is based on the merits of the services offered by the supplier and not on the size of the company involved. Tariff transparency and contractual conditions should be the norm for the industry working to common basic standards.

##### **Question 8.5: What is the best way to promote content standards and ensure privacy protection for increasingly complex content and transaction services? How will privacy issues fare in a world where services are more personal and more complex?**

No comment

##### **Question 8.6: Will the mobile termination rate regime need to evolve or change more fundamentally? What is the best approach to adopt?**

All undertakings should receive a reasonable rate of return on the capital invested  
Caller pays is the fairest regime- the general public would balk at the prospect of having CPP  
and having to pay for scam calls or cold marketing calls

***Question 8.7: If competition does not reduce international roaming charges sufficiently, how should regulators respond, if at all?***

It is important for NRAs to support EC proposals for international roaming charges.  
National roaming is an increasing demand by consumers in the UK and this should be  
opened on fair and reasonable terms to all operators not limited to the major incumbents.

***Question 8.8: How might universal service and universal access need to adapt in a world where we increasingly rely on mobile services? What role might mobile play in universal access delivery in future?***

As mobile services grow, particularly if new entrants can be encouraged to enter the market  
to deliver a range of service including in the not spots, then the demand for universal service  
may lessen, but end to end connectivity must be provided, including for SMS

***Question 8.9: Can markets and commercial agreements address issues such as 'not spots' and emergency access? If not, what role might be played by a regulator to address these issues?***

As mentioned in Question 8.8 above the market must be open to new entrants as the most  
appropriate option and investigation of interoperability with other services.

***Question 8.10: How might access for particular groups (such as the elderly and disabled users) need to evolve in future? What role can competition play in addressing these questions?***

Greater encouragement of retail competition will drive suppliers to develop services for  
particular groups

***Question 8.11: Do you have any comments regarding our proposed way forward and the objectives of the next phase of this Assessment?***

We support Ofcom's approach to enter into dialogue with stakeholders and we encourage  
Ofcom to review its own powers under the current Communications Act to ensure it can take  
actions in areas of market deficit. If not a reference to the Competition Commission would be  
the next step.

The current tight knit mobile sector can be opened to wholesale and retail competition but  
only with Ofcom's will and support.

## **Appendix 1**

### **FCS mobile market opinion survey- 2008: Summary report**

Following announcement of Ofcom's Mobile Sector Assessment review in March 2008, FCS has carried out a series of surveys among its telecoms members to obtain their views on the mobile market. Responses were received from a representative sample of a range of communications providers, some of which are currently providing services and some seeking to enter the mobile market.

#### **Current Supply Arrangements**

*For members currently delivering mobile services, we asked whether they had any concerns about their current supply arrangements or the ability of the services offered to meet customers' needs.*

- Most respondents expressed the view that current supply arrangements are restricting competition and that they are not experiencing a level competitive playing field. Specifically, many felt that the Mobile Network Operators [MNOs] undercut wholesale prices with direct sales. Service providers and resellers are restricted to a limited range of pre set deals offered from mobile operators. Instances have been cited of MNO pricing which is at least double what any reasonable size SME (i.e. with 50 handsets or more) would get if they go to the MNO direct.
- Some distribution companies were perceived as lacking in appropriate product and airtime knowledge, leaving dealers and service providers to source this information for themselves.
- There is also a perception that indirect sales are subject to unnecessary red tape which prevents them in adhering to their delivery times creating difficulties in managing customer expectations.
- Dealers and service providers also feel that they are disadvantaged by the fact that MNOs prioritise their own stores and direct sales force, irrespective of when orders were placed with them.
- MNOs also often seek to bill the end-user customer direct. This used to be the case in the fixed line market, but now the fixed line service provider or reseller owns the customer relationship. With their foray into fixed line, the MNOs are able to compete against fixed service providers for the same services and yet the fixed line service providers cannot compete against them.
- Service providers providing services based on WLR and CPS would also like to be able to offer clients the ability to take monthly billed minutes and line rental directly with themselves and to bill on a consolidated basis, something that their customers request.
- Several instances were also reported of MNOs suspending access for their customers to new entrant mobile number ranges. Many customers of the new entrants were the forced to stop using the service, because they could not receive calls on their mobile number and with the big players controlling market customers had no other choice but to use a different provider.
- Many members who do not currently provide mobile services are keen to do so but are deterred by a combination of the above issues

#### **Barriers preventing service providers from providing mobile services.**

*We asked members if there were any perceived barriers to their provision of mobile services.*

Members cited the unavailability of commercially viable or competitive wholesale offers in the business to business space.

- Respondents complained about a lack of availability of reseller packages which would enable smaller players to provide a consolidated bill to end-user customers for both fixed and mobile services.
- Unwillingness on the part of MNOs to deal with smaller players was also cited.
- Problems with provision of access to new entrant number ranges either via slow data build or unilateral closing down of some ranges.
- Direct offers and promotions offered by MNOs that service providers are unable to compete with without losing money. Access to support and training that is required for new products and services is also seen as a problem.
- Inefficiency of current porting processes such as delays in provision of PAC codes.
- We are unable to find a network operator who is willing to let us wholesale their traffic and on bill to our clients.

### **End-user customer experience**

*We asked whether members believe that end-user customers are currently getting a good deal in the mobile sector.*

None of the respondents felt that customers were getting a good deal. Members felt that their customers want converged and integrated delivery but that MNOs are restricting access via resellers thereby reducing customer choice.

Respondents said:

- “Using a mobile phone is costly particularly for services such as roaming and data”
- ” Because there is no alternative service customers have to pay “extortionate” fees to make and receive calls. Alternative products from SPs which address this are seen as a threat by the big players.”
- “Clients are basically unaware due to the complexity of the offers”
- “Why is a mobile call to a UK landline still at an average of 10p per minute greater? The same call on the PSTN is 1.5p.”
- “The trend for reducing dealer commissions and increasing offers on longer contracts, intended to reduce customer churn, will bind customers into longer contracts which may make it more difficult for customers to move to another supplier to gain a better deal”
- Several reseller respondents cited the high levels of customer care that they provide for their customers, which they believe cannot be replicated by the larger MNOs.
- “With the networks taking over business customers directly, competition is minimal once the customer is direct. The networks do not then act in the interests of the customer, as a dealer would.”

### **Competition**

*We asked whether there is sufficient competition in the sector at either the wholesale or retail level.*

There was a very clear consensus that competition is not effective.

- Service provider and resellers are effectively frozen out and choice is restricted to the four main providers who our members say are less innovative and competitive and do not offer sufficiently transparent rate cards.
- The fact that MNOs can sell direct to end-user customers is the major issue without any requirement to provide viable wholesale services. This is borne out by the fact that there are 5-6 operators compared to several hundred fixed line carriers/resellers.

### **Regulatory remedies**

*We asked whether members' believe that regulation on the Mobile Network Operators should be reduced or increased (e.g. to require them to provide access to appropriately priced wholesale services)?*

Most respondents favoured a specific increase in regulation to prevent MNOs from undercutting service providers which it is believed undermines the entire industry and confuses the customers. Most indicated that MNOs should be forced to provide a workable wholesale model

It was specifically suggested that there should be SMP on mobile call origination.

### **Other comments on the sector.**

- The unfair method adopted by the Networks on restriction of customer amendments to their tariffs. Most are not allowed to amend for the first 6 months of a 12 month, 8 months of an 18 month, and 12 months of a 2 year contract, with one MNO allowing no amendment on a 2 year contract
- Cashbacks have created a problem area in the industry, and should be controlled better from a dealer and customer viewpoint.
- Network Poaching on Dealer orders, which could be simply eliminated, by adopting the same method of note-padding a customer account with the Dealers code and date of contract, as they do for Specialist Dealers.
- The sector should be further split up into separate data and voice propositions, therefore allowing staff to be adequately trained in both: hence giving the independent channel and more importantly the end user a more informed decision upon their product.

## Appendix 2 Wholesale SMS

SMS provides a mechanism for transmitting short messages (up to 160 characters) between mobile handsets and between fixed devices and mobile handsets using the mobile networks. SMS services are incorporated in a wide range of messaging applications. For instance, emergency search and rescue services can use SMS as a two-way alert system between controllers and team members, and e-mail SMS solutions can be created to allow customers to send and receive SMS through their existing e-mail software.

Essentially, the mobile network infrastructure that is used to send and receive SMS is the same as that used for the delivery of voice calls, except that SMS are routed through short message service centres (SMSC). As with voice calls, an SMS must also be "terminated" on the mobile network to which the intended recipient subscribes. The sending party typically pays for the entire cost of the SMS.

Rather than pay the mobile network operators' (MNOs) usual retail prices for SMS delivery, customers wishing to send large volumes of SMS can negotiate volume based discounts with the MNOs. The disadvantage to them in doing so, however, is that they are required to enter into agreements, and establish direct interfaces, with each MNO.

Many commercial customers choose instead to use companies which act as intermediaries between the MNOs and provide the customer with a single interface. These companies are commonly referred to as "aggregators" because, by aggregating all of their customers' demand and then purchasing SMS services from each of the MNOs in bulk, they can enjoy economies of scale which allow them to buy SMS services at wholesale prices. Therefore, by using an SMS aggregator, a customer can reduce the complexity and cost of sending bulk SMS (also referred to as "SMS Push").

By using its network infrastructure an SMS aggregator can enable messages generated from a mobile device, PC or software application to be routed to another mobile device, employing third party mobile networks to carry the data.

An aggregator can purchase SMS services by:

- (a) Purchase an MNO's wholesale SMS service
- (b) Purchase an intermediary's service
- (c) Purchase SMS termination from an MNO via an SS7 interconnect

Option c provides the aggregator with the greatest control over the quality of service offered to its customers. However, commercial negotiations between small aggregator companies and large mnos, including the termination rates charged, reported by FCS members, can fail due to the larger commercial weight of the incumbents. Without an acceptable margin aggregators are unable to supply services and these services are not always replicable by the mnos themselves.

In this unbalanced situation when the demand for SMS services is increasing the regulator, Ofcom, should review the wholesale rates offered and provide a steer to the industry. Ofcom has appeared reluctant to intervene in cases of small players despite the fact that innovative services for business and consumers are at stake.

We recommend that the proposed Wholesale SMS termination review promised two years ago is commenced with haste. There is now information in the marketplace for Ofcom to conduct its work effectively, without requiring parties to issues a formal complaint to Ofcom.

Ofcom noted in its 2006 proposal that the French regulator has imposed a price cap on wholesale SMS termination of 3-3.5 euro cents. More recently the European commission

proposes to cap charges for roaming texts at a maximum of £0.09. The European trend is price reduction and this should not be a reason to prevent innovative aggregators from entering the market.

Press reports on this issue can be found at:

<http://www.hslsms.com/documents/HSL.EU.MNO.Abuse.20070307.pdf>

[http://www.theregister.co.uk/2008/09/23/eu\\_reding\\_sms\\_data\\_roaming\\_caps/](http://www.theregister.co.uk/2008/09/23/eu_reding_sms_data_roaming_caps/)

SMS is also an issue within the mobile number portability saga reported on page 3 of this response

While any mobile customer, business or consumer, would expect to be able to make voice and SMS calls after porting their mobile number to a new supplier, arguments against the inclusion of SMS within the mnp regime have been proffered by some mnos contributing to the delay in achieving mnp for new entrants in the UK.

#### **Recommendations to Ofcom:**

SMS must not be differentiated from voice within mobile number portability and Ofcom must clearly state its policy and implement where transgressions occur. We also recommend

- Ofcom should review the SMS market as regulation would seem necessary to remove the current market distortion where wholesale SMS is higher than retail pricing – For example the French and Spanish authorities have recently regulated the SMS termination market
- There should be an obligation similar to voice that covers the routing of SMS as this is a barrier to new entrants, e.g. the issues that new entrants have endured as there is currently no such obligation. (Obligation to Buy)
- Ofcom should allocate SMS short codes, in effect increasing competition in this market, as at present only BT can offer multi network short code SMS services.

**Appendix 3**

**May 2001**

**Response by the Mobile Independent Service Providers  
Group of the FCS  
to the Of tel consultative document**

**Effective Competition Review: Mobile**

**Issued by the Director General of Telecommunications**

**February 2001**

*Contact:*

Jacqui Brookes  
MISP Secretariat  
FCS Limited  
Keswick House  
207 Anerley Road  
London SE20 8ER  
Tel 020 8778 5656

**CONTENTS**

<b>1. Summary</b>	<b>24</b>
<b>2. Introduction</b>	<b>24</b>
<b>2.1 MISP</b>	<b>24</b>
<b>2.2 Mobile market review</b>	<b>24</b>
<b>2.3 Explanatory notes</b>	<b>25</b>
<b>PART 1</b>	<b>26</b>
<b>3. Commentary on the Consultation Document</b>	<b>26</b>
<b>3.1 Chapter 1 Growth of the UK mobile sector</b>	<b>26</b>
<b>3.2 Chapter 2 Effective competition review</b>	<b>27</b>
Indicators of effective competition: consumer outcomes	27
Indicators of effective competition: Consumer behaviour	28
Indicators of effective competition: Market structure	29
Indicators of effective competition: Supplier behaviour	32
Effective competition review: summary	33
<b>3.3 Chapter 3 Market Power in the mobile sector</b>	<b>33</b>
Do Vodafone and BTCellnet still have market power?	33
Do One2One and Orange have market power?	34
<b>3.4 Chapter 4 Implications for regulation</b>	<b>34</b>
If the mobile sector is found to be effectively competitive	34
If effective competition does not exist	35
<b>3.5 Chapter 5 Next steps and consultation</b>	<b>36</b>
<b>4. Answers to questions for respondents</b>	<b>37</b>
<b>Market definitions</b>	<b>37</b>
<b>Prices and consumer outcomes</b>	<b>37</b>
<b>Market structure and ISPs</b>	<b>38</b>
<b>Profitability and efficiency</b>	<b>40</b>
<b>Future regulation</b>	<b>41</b>

<b>PART 2</b>	<b>42</b>
<b><i>Vertical integration and competition in the mobile communication services market</i></b>	<b>42</b>
<b>1. Introduction</b>	<b>42</b>
<b>2. Independent service providers: achievements and present position</b>	<b>42</b>
<b>3. Effective competition, market power and oligopoly</b>	<b>44</b>
<b>4. Oligopoly in the network market</b>	<b>46</b>
<b>5. Vertical integration: a source of efficiency?</b>	<b>48</b>
<b>6. ISPs and network competition</b>	<b>48</b>
<b>7. Concluding observations on regulation</b>	<b>51</b>
<b>Curriculum vitae Basil S Yamey</b>	<b>53</b>
<b><i>Confidential Annex 1</i></b>	<b><i>Error! Bookmark not defined.</i></b>

## 1. Summary

In this response to the *Effective Competition Review: Mobile* consultation the Mobile Independent Service Provider Group ("MISP") argues that:

- the UK mobile market is not effectively competitive, there is no prospect of effective competition in the two year term of the review and, given the market structure, in the medium term; but does not exclude effective competition arising at some point if retail competition is encouraged. Suggestions are made as to how retail competition can be encouraged through effective regulation;
- the oligopolistic nature of the market, de facto, means that each of the four MNOs have market power. A report on why this is the case is included;
- if ISPs had access to unbundled network services at cost based prices they would introduce real competition in prices at the retail level;
- Oftel should be proactive in acting to prevent leverage of market power by MNOs, foreclosure of access and exclusive arrangements; and
- Oftel must be better resourced to remedy breaches of the regulations in a timely way, to minimise damage and prevent unfair first mover advantage being gained particularly in the introduction of new non-voice and other value added services in the future, for example mobile Internet.

The economic analysis in this response leads MISP to conclude that the structure of the mobile market as it stands with 4 or 5 network operators will not lead to effective competition. Oftel should not put in a short-term plan of removing the obligation to sell to service providers and then have to reinstate it once it has undertaken another review. The obligation can only be removed when there is a sustained period of market restructure some time far into the future.

## 2. Introduction

### 2.1 2.1 MISP

The Mobile Independent Service Provider Group is a semi-autonomous group within the Federation of Communications Services ("FCS") the mobile communications trade body. MISP represents organisations that have a service provider agreement with one or more mobile network operators ("MNO") and are not controlled directly or indirectly by an operator licensed under Section 7 of the Telecommunications Act. MISP admits associates and members (who are also members of FCS) who agree to be bound by a written constitution.

MISP members presently provide services to a substantial proportion of all the consumers in the independent sector of the market.

For details of MISP members see the FCS web site at [www.fcs.co.uk](http://www.fcs.co.uk).

### 2.2 Mobile market review

MISP welcomes the publication by Oftel of the consultation document *Effective Competition Review: Mobile* ("MMR"). The MMR is a substantial work that includes a comprehensive review of the UK mobile market. Oftel is to be applauded on the depth of the review, the analysis, the presentation of detailed arguments and evidence.

This document is MISP's response to the MMR. It is in two parts. Part 1 is a commentary on the consultation document and includes answers to the questions raised by Oftel. Part 2 is a review of the role of Independent Service Providers ("ISP") in the mobile telephony market in

the United Kingdom, particularly in relation to vertical integration and competition in that market. The report in Part 2 has been commissioned by MISP and written by Basil S Yamey. A short curriculum vitae of Professor Yamey is appended to the report.

2.3 Explanatory notes

2.3.1 Numbers prefixed with § refer to paragraph numbers in the MMR.

2.3.2 Numbers prefixed with §§ refer to paragraph numbers in Part 1 of this document.

### 3 PART 1

#### 3. Commentary on the Consultation Document

3.1

3.2 3.1 Chapter 1 Growth of the UK mobile sector

3.1.1 The growth in the UK mobile sector since the 98/99 review has been significant. However MISP would question the absolute number of “real” subscribers since it has been reported that there are many pre-pay handsets registered which do not make calls. Recent press and analysts reports suggest that customer numbers for all MNOs are grossly overstated, Vodafone has announced that 9–10% of its pre-pay base is unreal and speculation generally is that 25% of pre-pay users are mythical. Certain MNOs do not recognise that customers have deserted, or were never connected, until the expiry of up to twelve months following registration. This means for example that desertions from sales of pre-paid phones over the Christmas 2000 selling period will not yet have been seen in the returns. It is also worth noting that growth in new subscribers, particularly in the consumer pre-pay sector, is unlikely to be sustained at recent levels. The pre-pay market is approaching saturation; MNOs are setting handset prices higher in an attempt to obtain a return on their investment in subscribers. Recent announcements by the MNOs suggest that the industry’s focus will shift from market growth to customer retention and retention of value.(§ 1.4)

3.1.2 ISPs obtain their trading margin from the declining revenue from access and domestic calls. They do not participate in incoming call revenues or wholesale roaming revenues and have a minor participation in roaming abroad. These factors which materially effect the viability of ISP businesses coupled with pre-pay, to which ISPs have no access<sup>1</sup>, are contributors to the decline in the number of service providers in the independent sector. (§ 1.5)

3.1.3 MISP broadly agrees with OfTel’s view of the mobile sector in that it comprises distinct wholesale and retail markets. A large proportion of pre-pay subscribers fall into one or more of the following categories –

- want to remain anonymous,
- not credit worthy,
- member of the cash society,
- under 18 years old,
- do not want the ongoing liability of a post-pay contract
- only have the phone for emergency use (glovebox users).

MISP believes that these features of the pre-pay market make the pre and post-pay markets distinct retail markets within the broad retail mobile sector. (§1.9)

3.1.4 Indirect Access could be a valuable component for ISPs enabling them to develop their own innovative services. However due to the pricing structure and the wholesale prices charged by BTCellnet and Vodafone for IA conveyance the take up of IA will be non existent. MISP’s view is that the prices as determined by OfTel, using

---

<sup>1</sup> Vodafone offers a wholesale pre-pay service to ISPs however the margins are not sufficient to operate a viable business and consequently the take up has been negligible.

the retail minus principle, in relation to the INMS dispute preclude prospective service providers from offering competitive retail services using IA. (§1.14)

3.1.5 MISP is pleased to acknowledge the reinstatement of the MI determinations by OfTel in respect of BTCellnet and Vodafone. For the time being legal certainty in the supply of MRTS to service providers has returned. It is wrong to state that service providers can rely on their commercial contracts with the MNOs for continuity of airtime supply as, amongst other things, these contain no provisions on “not showing undue preference or undue discrimination”. (§1.18)

3.3 3.2 Chapter 2 Effective competition review

(a) Indicators of effective competition: consumer outcomes

3.2.1 **UK consumers shown to enjoy 'best or near best deal' in comparison with consumers in similar economies.** MISP would argue that a relative test involving similar economic markets comprising MNOs who have market power and where that market is not fully effectively competitive is simply comparing like with like. It does not indicate that a consumer is enjoying **the** best or near best deal, in reality all the deals may be bad. The Government has stated that it wants the UK to lead in e-commerce and that the UK consumer must have **the best**. As a direct result of the lack of effective competition in an oligopolistic market the Danish government for example has mandated MVNOs and adopted a policy of openness not apparent in the UK market. Will OfTel publish for comments the results of any further benchmarking exercise completed before the MMR concludes? (§2.3)

3.2.2 **A wide range of services available to UK consumers.** MISP's view is that the choice of services available to UK mobile consumers is unreasonably constrained by the lack of unbundled elemental tariffs from MNOs, by the non-availability or high price of services and by the cross subsidisation of certain services by MNOs. In particular the wholesale charges for MRTS paid by service providers are based on the MNO's bundled retail package with a discount applied. This leaves little or no scope for pricing innovation by service providers, which would otherwise provide price competition in the market. More importantly, pre-pay services have been predominant in the market for the past two years, these services for the most part have not been available to independent service providers and there has been no competition in the supply of pre-pay services on the BTCellnet and Vodafone networks. (§2.5)

3.2.3 Those innovative services, which might have been developed by independent service providers had MVNOs been mandated in the UK or had IA been made available at a reasonable wholesale cost are not available to consumers.

3.2.4 As regards voice tariff packages MISP notes that “all-in-one” propositions are being withdrawn by certain MNOs and that recently prices for pre-pay handsets are being raised by similar amounts by all MNOs, an indication of “parallel behaviour” and confirmation of limited competition in an oligopolistic market. The objective being to reduce handset subsidies, increase profitability and attract customers to the more valuable contract post-pay services. MISP expects that the choices available from the MNOs will decline as MNOs seek to enhance their profits from a captive audience of consumers.

3.2.5 In summary MISP does not share OfTel's view that there is a wide range of services available today. Moreover it is expected that the choice of basic services available to consumers will decline in the future. A wider range of services will only come through increased retail competition.

- 3.2.6 As regards 3G services there is considerable uncertainty about network roll out and informed comment on the viability of the networks in the medium term. Recent reduction in subsidies demonstrates MNOs determination to recoup some of their investment in 3G licences from 2G services even before 3G networks are built. Whilst considerable investment is being made by ISPs to ensure IT and billing systems are compatible with new GPRS and 3G services, further eroding already scarce margins, MISP believes that in the present review the effect of 3G, if any, should be disregarded as being of no relevance. (§2.7)
- 3.2.7 **Consumer satisfaction.** MISP broadly agrees with Oftel that consumers are satisfied with their mobile service today. Signs are on the horizon that this may not continue; there is the big issue of poor customer services provided by MNOs. Following the introduction of GSM there was significant dissatisfaction because of coverage gaps and technical problems. The same can be expected with the introduction of new network services, GPRS for example, and the migration from 2G to 3G networks over the next decade. The concern of residential consumers regarding the price (of first time joining) will increase as pre-pay handset prices rise. The complaints of business consumers about dropped calls can be expected to increase as the networks suffer peak time capacity constraints as users and/or usage increases. (§2.10)
- 3.2.8 It is understood that Vodafone has commissioned independent research but MISP would be interested to learn from the Oftel surveys whether business consumers experience any better or worse customer care when they deal with an independent service provider as opposed to a tied service provider of BTCellnet or Vodafone. (§2.14)

(b) Indicators of effective competition: Consumer behaviour

- 3.2.9 **Consumers able to access and use information to help make effective choices and take advantage of market opportunities.** MISP agrees that the majority of first time mobile consumers are not knowledgeable. The price of joining, not the cost of ownership, figures highly in their buying decision and usage patterns are not known or considered initially. This has probably always been the case. Mobile phone tariffs from all the MNOs are complex, likely to confuse and it is not easy to compare like for like especially when taking a handset subsidy into account. If cost based elemental wholesale airtime were available, ISPs would be able to remove much of the confusion by constructing simple tariffs where the benefits of one tariff over another was obvious to a consumer. (§2.17)
- 3.2.10 **Absence of barriers to consumers switching suppliers.** Providing *mobile number portability* ("MNP") represents a significant cost for all players in the mobile industry. Except for certain business users MISP questions the benefit of MNP since the number of ports is so low and the administrative and technical costs are so high. Most of the MNO's do not have adequate plans in place to ensure sufficient capacity for handing over MNP calls between their networks. This has resulted in very severe disruption in service for many MNP customers. In addition many customers wrongly assume that once ported from, say, Vodafone to BTCellnet, anyone calling them from a BTCellnet handset will be charged a cheaper rate by their service provider. Given broadly equal amounts of porting between the four mobile networks, independent service providers are net losers of customers to MNP. ISP's customers can port out to any other service provider or MNO but ISPs can only port in to the BTCellnet and/or Vodafone networks. MISP members report that porting out of most MNOs in practical terms is made as inconvenient as possible and that there are particular processing difficulties in porting numbers away from the Orange network.

- 3.2.11 Generally the porting process and the technical solution is problematic which may contribute to the fact that the number of ports is low compared with Oftel's expectations. Or it may simply be, as argued in the consultations before the introduction of MNP, that for the vast majority of residential mobile subscribers their mobile phone number is of little value. In any case the process and the elegance of the technical solution needs to be improved before porting can contribute to the development of effective competition. A national MNP website is urgently required; Oftel should do all it can to ensure this is implemented speedily. (§2.20)
- 3.2.12 MISP views *SIM locking* as an inevitable consequence of a market in which handset subsidies are provided to post-pay and to unidentified pre-pay consumers and it restricts consumer choice. MISP members report that un-subsidised handsets purchased from BTCellnet are currently SIM locked and that BTCellnet refuses to provide unlock codes. SIM locking restricts competition by making it practically more difficult for consumers to change service provider or network. Initiatives by independent service providers to introduce SIM only services in the UK over several years have not been successful because of SIM locking and the practice by MNOs of linking incentive payments to the sale of a new handset. These practices by MNOs constitute a barrier to entry at the service provision level, which serve to further reduce consumer choice. (§2.22)
- 3.2.13 As regards *switching behaviour* experience amongst MISP members suggests subsidised handset upgrades may be a major part of consumers' motivation to switch. (§2.25)

(c) Indicators of effective competition: Market structure

- 3.2.14 MISP shares Oftel's belief that market structure is a key determinant in the development of effective competition. This belief is developed in Professor Yamey's report in Part 2 of this response. (§2.26)
- 3.2.15 MISP would point out that the obligation on BTCellnet and Vodafone to supply mobile airtime to ISPs stems from the original mobile licences (practically effective from January 1985). The term MI was introduced in the current licences. In their original licences Orange and One2One also had the supply obligation and, despite this obligation, failed to provide mobile airtime for some considerable time after their launch. When wholesale airtime was finally supplied following many complaints to Oftel and a prolonged investigation it was on such anti-competitive terms as to be of no commercial value to ISPs. The obligation to supply airtime to ISPs was removed in the current licences when Orange and One2One were deemed by Oftel not to have market power. (§2.27)
- 3.2.16 **Market shares by network operator.** MISP notes that One2One which has vigorously pursued the residential consumer market for pre-pay services to gain market share and, as a consequence, has the lowest retail revenue per customer (less than 62% of Vodafone's). One2One has (since the publication of the MMR) announced a change in strategy to replace market share growth in pre-pay at all cost with retaining customer value (One2One press release 22<sup>nd</sup> March 2001). The press release also announcing a £20 increase in the entry level handset prices for pre-pay phones a rise which has been mirrored within days by BTCellnet, Orange and Vodafone. MISP suggests that not only do these events provide evidence of "parallel behaviour" but that effectively all the MNOs have market power. (§2.32)
- 3.2.17 **Market shares: network operator and independent service providers.** The market share of ISPs has fallen significantly in the past three years from 26% in Q4 97/98 to less than 7% today. This is a result of the introduction and growth in pre-pay services, the alleged unfair cross subsidies by BTCellnet and Vodafone, the so called

margin squeeze, the change in incentive payment schemes (see §§ 3.2.20) and the failure by Oftel to enforce the requirements of the Oftel formula. ISPs have been effectively excluded from the supply of pre-pay services. Not only has this resulted in no share of the growth in this market sector but has also contributed to an increased churn amongst existing customers moving to pre-paid services that ISPs were unable to supply. The margin squeeze has resulted in ISPs profits being lowered so that they cannot invest in the acquisition of new customers and are consequently unable to compete against the cross subsidised tied service providers ("TSP") for new post-paid contract business. ISPs have been forced out of the business or have had to accept positions as niche players; some have done this successfully. It has become clear to ISPs although they could offer innovative and high quality services to residential consumers that without additional support from the MNOs, which is provided to tied service providers through cross subsidies, this is simply not viable. The model does not make sense because the acquisition costs are high, the customer life is short, and the revenues and margins are low. The residential consumer bases of many of the remaining ISPs are consequently for sale and unless action is taken the ISP market share will continue to erode. Nevertheless ISPs still account for over 25% of contract customers connected to the BTCellnet and Vodafone networks and a significant proportion of the business consumers. (§2.34)

3.2.18 Business consumers in particular value the range of services that only ISPs can provide. Their requirements are considerably more complex and demanding than residential consumers and it is therefore easier for ISPs to add value in what they supply. Network tied service providers and direct businesses by definition only provide the services of their network. ISPs become the "one stop shop" for all the communications services needs of their customers. The services provided in this context include-

- access to two mobile networks, fixed networks, data networks and paging;
- Internet services, gateways and portals, unified messaging;
- value added services, handset rental, accessories, repairs, specialist installation, support for non-voice applications, SIM only services;
- special billing requirements, bespoke reports, multiple network services on one bill, e-bills and SMS bills, online billing, automatic tariff health checks and unique tariffs;
- customer services, high quality individual services, named consistent customer contacts, advisory services and dedicated help desks.

It is worth mentioning that Aerofone (an ISP) has won the Mobile News award for Best Service Provider for the last two years. Four out of the five finalists this year were ISPs. The finalists were Aerofone, Intercell, Project Telecom, RSL Com and Vodafone Corporate (a TSP).

3.2.19 To survive in the market at all ISPs have to be at least as efficient as MNOs internal service providers and TSPs but, as pointed out in Part 2, this only applies where there is a level playing field. This is clearly not the case in the UK mobile market.

3.2.20 ISPs have seen the structure of their connection and retention packages from BTCellnet and Vodafone change significantly over the last few years. More of the ISP income has become discretionary on the party of the MNO, outside of the regulated supply of airtime and not subject to the undue discrimination provisions of the licences. Recent examples of discretionary payments are given in Confidential Annex 1.

3.2.21 Oftel makes the assertion that in an effectively competitive market if ISPs are an efficient route to market MNOs will supply them. MISP believes ISPs are an efficient route to market but unless they have an obligation MNOs will not supply to the

generality of ISPs. It is encouraging that MNOs are negotiating wholesale agreements with potential new entrants, it remains to be seen whether these negotiations conclude successfully but in any event begs the question why have wholesale services not already been offered to ISPs? MISP's overriding view is that the market can never be effectively competitive whilst there are four (or five) MNOs and insurmountable barriers to further entry at the network level. (§2.35)

- 3.2.22 **Limited entry barriers, which would make the threat of entry a competitive discipline.** MISP agrees that the *barriers to entry at the retail level* as an ISP selling post-paid services are seemingly not high and the industry welcomes potential new entrants. It remains to be seen how these new entrants (if any) perform in the market, whether they are able to make profits or otherwise obtain a return on their investment and if this comes from mobile airtime alone (MRTS i. e. from the regulated services). And how they are supported by their MNO with "soft" margin. Many potential new entrants have been signed up as virtual service providers ("VSP") or resellers by ISPs, rather than as ISPs by MNOs. The process of becoming an ISP is slow; it requires a large investment in billing and customer services infrastructure. Acceptance of an ISP is subject to the MNO agreeing a business plan, substantial financial guarantees may be required as a prerequisite and a legal first charge over the ISP's assets, including its customer base. This means that substantial additional capital is required as working capital since bank borrowings can no longer be secured against the assets of the business. Whilst, in accordance with their licences, BTCellnet and Vodafone cannot reasonably refuse an applicant ISP, in practice the process is slowed down to such an extent that many potential new entrants end up taking the VSP route. This is particularly the case for entrants with no track record in mobile or those who are new or small businesses. VSPs almost exclusively address the business market as the margin obtained from supplying residential consumers is not sufficient to build a viable business from scratch in today's market. Oftel makes reference to Virgin Mobile in the context of a new entrant on the One2One network. It should be noted that this business is a joint venture between them and as such is not a new entrant merely a new brand. The business is entirely in pre-pay. Significant funds have been invested by Virgin Mobile in growing a customer base with, it seems to MISP, no immediate prospects of obtaining a return. (§2.37)
- 3.2.23 As regards pre-pay, ISPs complained to Oftel about their exclusion from the supply of wholesale pre-pay services in 1998. It took Oftel almost two years until July 2000 to investigate the matter and report by which time the pre-pay market was dominated by the MNOs. The wholesale prices subsequently announced by Vodafone for pre-pay do not allow an ISP to operate a viable business. During this two year period the pre-pay market was penetrated by the four MNOs and latterly by Virgin Mobile (see §§ 3.2.21) to the extent as to make it no longer worthwhile to the remaining ISPs (§2.38). MISP members that distribute pre-pay on behalf of MNOs have had difficulty getting access to handset stock with MNOs giving preference to their own in-house channels and they are faced with unrelenting margin pressure since the market became established.
- 3.2.24 The *barriers to entry at the network level* in MISP's view remain insurmountable. The entry by Hutchison 3G within the time scale for the MMR is not certain nor is the prospect of further competition as a result of this entry if it takes place. Equally the effect that Dolphin will have on competition in the mobile telephony market, if at all, is minimal. MISP proposes that they both be disregarded for the purposes of the MMR. (§2.40)
- 3.2.25 MISP agrees that Orange and One2One have become firmly established in the market but that they have not gained the same recognition in the business sector as they have in the residential sector. Members' report that many large business users who have tried Orange and One2One have subsequently returned to BTCellnet and Vodafone. (§2.42)

- 3.2.26 **Potential for the leverage of market power in the mobile sector.** MISP agrees with Oftel that services that add value are the key to the future retail market and shares Oftel's concerns that there is potential for abuse of market power. This identifies a clear need for continuing proactive regulation to prevent the exclusion of ISPs from these emerging services. There are precedents, for example in voice messaging, SMS and of course pre-pay, where ISPs were excluded from the start. Messaging is also a good example of consumers receiving a basic, expensive service from the MNOs simply because ISPs cannot compete against the cross subsidies to provide more advanced services. By the time reactive regulation has been applied the market has been comprehensively penetrated by the incumbent with first mover advantage, competition is thwarted to the detriment of the consumer. (§2.43)
- 3.2.27 The bundling of services and wholesale charges for ISPs based on the MNOs retail prices for its services bundle all contribute to lack of choice, innovation and competition in emerging services. ISPs need unbundled elemental services at cost based prices as inputs on which to construct their own services for customers.
- 3.2.28 MISP agrees with Oftel's view on the leverage of market power into new emerging retail services and the detrimental effects this would have on suppliers and consumers if exclusive arrangements apply. These comments also apply to access mechanisms and charges that penalise consumers who access non-favoured portals. Oftel must be proactive in ensuring such leverage cannot be used unfairly by those with market power. (§2.44, 2.45)

(d) Indicators of effective competition: Supplier behaviour

- 3.2.29 **Active competition on price.** MISP notes that price competition on *access and domestic outgoing calls* as between service providers retailing services on the same network is muted. This is because ISPs' inputs are the bundles which comprises the MNO's retail proposition and because ISPs are compelled to pass the MNO's retail proposition to the customer complete and unchanged (§2.48). It is worth noting the unfair nature of incentive payments provided to ISPs by MNOs that are subject to the ISP revealing the names and addresses of its customers. For example to qualify for upgrade payments, to sell certain tariffs (Ahead for Business), to obtain an increased margin (Vodafone Volume Tariff) and for retrospective discounts (Cellnet First).
- 3.2.30 MISP agrees with Oftel that there is no evidence of competition in the supply of *off net mobile to mobile calls* and *international roaming calls*. In the case of off net calls this could be an indication of not only interaction between the four MNOs but also the high mobile termination charges which are being addressed elsewhere by Oftel. The handling charges for international roaming imposed by UK operators are excessive with ISPs no longer having any material participation in these charges (§2.49 – 2.51). MISP notes the recent remarks of the European Competition Commissioner in warning mobile phone groups over charges for roaming (Financial Times 25<sup>th</sup> April 2001).
- 3.2.31 There has been a massive growth in the number of *SMS* messages being transmitted across the UK mobile networks in the past two years. It has been reported that there are now over 800 million messages per month. There is no competition on price; a message originator has no choice as to which SMSC processes the message. Service providers are precluded from connecting their SMSC to the mobile networks and in some instances are required to buy another service from the operator to gain access to the operator's SMSC. The profit for MNOs from SMS traffic is over 80% of the wholesale price reflecting the effect of the lack of true competition. MISP welcomes Oftel's plans to continue to monitor the price of SMS closely. (§2.53 – 2.55)

- 3.2.32 **Absence of anti-competitive behaviour.** Having suffered the effects, MISP members have been responsible for making representations to Oftel alleging anti-competitive behaviour by MNOs. In all these cases there has been a time gap of many months between the complaint and the conclusion of the Oftel investigation during which time an ISP will have sustained damage. MISP would simply remark that because Oftel's investigation did not substantiate the allegations when they were investigated does not mean there was not anti-competitive behaviour at the time representations were made. (§2.64)
- 3.2.33 **Absence of collusion.** The issue of collusion is discussed in Part 2 of this response. The experience of MISP members is that there is "price signalling" (without this necessarily being evidence of any form of collusion). A recent example is the announcement of an increase in the retail price for pre-pay handsets, which include connection and initial service, by One2One (see §§ 3.2.16); this was almost immediately followed by announcements of similar increases from BTCellnet, Orange and Vodafone. The experience is of price moves by any one MNO being quickly mirrored by the other three. (§2.64)
- 3.2.34 **Profitability, relative prices and efficiency.** MISP welcomes Oftel's conclusion that "Both Vodafone and BTCellnet may therefore continue to possess market power, since they are both able to raise prices above the competitive level for a non-transitory period without losing sales to such a degree as to make this unprofitable". (§2.72)
- 3.2.35 As regards Orange and One2One pricing above the competitive level MISP looks forward to the publication of the outcome of the *further work* commissioned by Oftel and to the opportunity to comment on it before the Statement is issued. (§2.81)
- 3.2.36 MISP notes that the lack of retail price competition could be ameliorated by encouraging ISPs to enter and remain active in the mobile market. Factors that would provide this encouragement include –
- certainty in the continuity of supply;
  - the supply of unbundled cost based elemental services;
  - IA at cost based prices;
  - access to mobile network functionality.
- (e) Effective competition review: summary
- 3.2.37 **In summary.** MISP agrees with Oftel's conclusion that the effective competition review presents a mixed picture (§2.88) and that "...the mobile market still falls short of effective competition". (§2.89)
- 3.2.38 **Outlook for the future.** MISP members have been saying for several years that true wholesale prices (i. e. not discounted retail bundles) are a key component in providing retail price competition in the mobile market. MISP is therefore pleased that Oftel notes this particular point but is equally disappointed that more progress has not been made towards competing services over the mobile networks and, seemingly, that the supply of such services are not in prospect. (§2.90)
- 3.4 3.3 Chapter 3 Market Power in the mobile sector
- (a) Do Vodafone and BTCellnet still have market power?

3.3.1 Based on the available evidence MISP agrees with Oftel that BTCellnet and Vodafone set prices above the competitive level and continue to possess market power. (§3.7)

(b) Do One2One and Orange have market power?

3.3.2 It is clear that One2One and Orange have become firmly established in the market, network coverage is similar for all four operators and they now each possess significant market shares. They should therefore no longer be regarded as new entrants or any different in this respect from BTCellnet and Vodafone. MISP believes there is some evidence firstly that One2One and Orange set prices above the competitive level and secondly that they are able to raise prices above the competitive level for a non-transitory period of time. The recent increase in the prices of pre-pay handset packages provides one example (See also Confidential Annex 1).

3.3.3 Both One2One and Orange have proportionately large pre-pay customer bases compared with their contract bases. One2One has for an extended period been able to set discounts to its distribution channel for pre-pay top-up vouchers at a substantially lower level than the other three operators. MISP notes recent changes in the wholesale price for distributors of paper top up vouchers which means that all the other MNOs have reduced their margin to be the same as that of One2One.

3.3.4 MISP looks forward to receiving the further evidence to be gathered by Oftel following the investigation into the profitability and efficiency of the MNOs. (§3.15)

3.3.5 It is MISP's view given the oligopolistic structure of the mobile market (§3.12) and the arguments put forward in Part 2 of this response that all four MNOs have market power.

3.4 Chapter 4 Implications for regulation

(c) If the mobile sector is found to be effectively competitive

3.4.1 MISP believes that there is overwhelming evidence that the mobile market is not effectively competitive.

3.4.2 Nevertheless if MI triggered obligations are removed from BTCellnet and Vodafone and they no longer have to supply wholesale airtime to service providers it will not be sufficient to rely on the provisions of the contracts in place with service providers at the time unless those contracts are changed materially over those in place today. The MI triggered obligation not to unduly discriminate against or show undue preference to particular persons is not reflected in the service provider commercial agreement and would need to apply in any transitional period where the relationship was governed exclusively by the service provider agreement. (§4.2)

3.4.3 The present service provider agreements are for a two-year term, expiring on 31<sup>st</sup> December 2001, and depending on the time when the MI triggered conditions cease to have effect the remainder of the contract term will determine the effective period of notice. This is not satisfactory and provision would need to be made for a fixed term of notice irrespective of the time remaining before the expiry of the subsisting agreements. MISP proposes that this notice period should be a minimum of two years.

3.4.4 If the MI triggered conditions cease to have effect on BTCellnet and Vodafone; and one or both of them choose not to continue to supply wholesale airtime to some or all of their existing service providers at the end of any notice period; then MISP believes that, failing agreement between the parties, Oftel must be prepared to determine the value of each of the subscriber bases to be transferred. In addition Oftel should be made aware the VSPs (see §§ 3.2.22) that rely on ISPs for their supply would also fall out of the market. Many of these are new entrants offering innovative services integrated across different networks many in the e-commerce area to businesses including SMEs where they are beginning to have an impact.

(d) If effective competition does not exist

3.4.5 **Retail price caps and cost-based access.** MISP believes in order to encourage service providers to enter the retail market and for them to develop competing innovative services, which are necessary for there to be the future prospect of effective competition, that cost based access is an essential prerequisite. Cost based access is applicable to IA today and should apply to MVNO and non-voice services in the future. (§4.6)

3.4.6 **Is the present MI framework appropriate?** Subject to the foregoing paragraph MISP believes if properly enforced by Oftel that the MI framework is an appropriate regulatory tool to deal with market power in the mobile market. In properly enforcing the MI framework Oftel must be proactive rather than always waiting for a formal complaint, must be timely in making enforcement decisions and most importantly needs to ensure it always has the appropriate information to hand, something it can require the MNOs to provide. Appropriate information would include price lists, changes, notices and incentive payment announcements. MISP's view is that Oftel should be better resourced by Government to fulfil this expanded proactive role. (§4.8)

3.4.7 MISP's believes that a wholesale unbranded, unbundled basket of elemental network services offered at cost based prices to service providers by MNOs is long overdue. However, MISP members would not want the unbranded proposition to replace the present branded services they would wish to retain the choice. If both services were available then the tension would be removed and those service providers with their own, or access to, well known brands would be free to develop their own services unconstrained by MNO brand values. Equally those (smaller) service providers for whom the MNO brand is of value could continue promoting the network branded propositions. (§4.9)

3.4.8 MISP members have argued in the past that the cost of marketing and brand promotion of a MNO should fall fully to the downstream retail operations and should not be borne by the upstream network operations. In a wholesale unbranded environment an ISP would gain no benefit from the costs of brand promotion. However, with the present structure where (some of) these costs are paid by the network operation a wholesale ISP would be contributing to these costs. It seems therefore that there is some merit in service providers taking a branded product being supplied from the operator's retail operation at prices which reflect that operation bearing all of the costs of brand promotion. The cost of the unbundled wholesale product supplied from the network operation would consequently be lower. (§A10.9)

3.4.9 There is scope for cross subsidy and abuse in securing the potential new revenue streams from data and other e-commerce and m-commerce services. MISP believes that greater regulatory scrutiny must be given to the ways in which MNOs seek to secure these new revenue streams. For the first time with the introduction of GPRS and eventually 3G there is the opportunity for ISP's to offer innovative services and applications independent of the MNOs to the benefit of the user. The MNOs are

already offering subsidised access to their own portals or subsidised traffic through SMS (free e-mail alerts for instance). Enhanced messaging is viewed as one of the most attractive applications in this new market for which companies offering such services are finding it impossible to compete with the operators' tariffs. As location based services become a vital element of mobile data applications it will be access to and control of location based information that will be a key determinant of financial success. Mirrored HLRs or access to HLRs should be mandated. The ability to enhance services for users will depend on ISP's ability to connect platforms to the mobile networks. This is currently refused from all mobile networks. SMS is perhaps one of the best examples where massive increases in volumes of super-profitable traffic has not been reflected in price cuts. Alternative network operators or ISPs have consistently been refused permission to interconnect SMSCs to offer competitive rates and services to consumers.

3.4.10 Oftel should be proactive in ensuring that anti-competitive practices do not take place in the inter linking of mobile with the Internet and the delivery of information and, in particular, location dependent services in order that markets are not foreclosed. It would be helpful if Oftel were to publish guidance not on products per se but on gateways and interfaces, access and exclusive arrangements. (§4.10)

3.5      3.5      Chapter 5 Next steps and consultation

3.5.1      MISP welcomes Oftel's proposed further steps to address the specific problems identified in the course of the review. (§5.5 to 5.12)

#### 4. Answers to questions for respondents

##### 3.6 Market definitions

**Q1.** Oftel believes that the updated market definitions will prove to be a useful tool to support future analysis of the mobile sector.

*Oftel seeks comments on its updated market definitions presented in Chapter 1 and the underlying analysis in Annex B.*

**A1.** MISP agrees that the mobile sector comprises distinct wholesale and retail markets and also considers that the retail market has distinct pre and post-pay categories. (§§ 3.1.3)

##### 3.7 Prices and consumer outcomes

**Q2.** Oftel considers that: competition on price for domestic calls and access, particularly on pre-pay tariffs, is very much in evidence; competition on the price of international calls is also evident; competition on the price of off net calls and international roaming calls is not evident.

Comments on these initial conclusions are sought, as is further market information on these issues.

**A2.** MISP generally agrees that some competition on price for domestic calls and access is evident. However MNOs act in an oligopolistic way all broadly reflecting the others' tariffs. Tariffs themselves are not designed to benefit consumers and do confuse. The offer of bundled tariffs, including inclusive minutes, are self evidently designed to offer consumers greater benefits than in reality they are getting. MISP understands that some 40% of the calls included in tariff bundles are not used. This breakage only benefits the MNO and the headline tariff as used by Oftel in making its assumptions may be bogus. Price competition on the same network is muted because ISPs receive discounts on the services bundle which is the network's retail tariff and have little scope to construct competing tariffs. ISPs would like access to cost based elemental airtime minutes, this would allow them to construct competing tariffs and enable true price competition to take place in the retail market. It is agreed that competition in the price of off net calls and international roaming calls is not evident. (§§ 3.2.27 – 3.2.28)

**Q3.** Annexes 4, 5 and 12 present the research used in Consumer Outcomes. Oftel welcomes any independent research that adds to its understanding and assessment of the deal the UK consumer gets in terms of price, choice and quality.

*Oftel welcomes any independent research that adds to its understanding and assessment of the deal the UK consumer gets in terms of price, choice and quality.*

**A3.** MISP cannot provide additional research.

**Q4.** As discussed in Chapter 2 and Annex D, Oftel believes that competition has delivered some benefits to consumers in terms of price, quality and choice but areas of concern remain. In particular, Oftel has expressed concerns: that it can be difficult for consumers to choose the best mobile deal; about price trends for off net mobile calls and international roaming and price transparency. In addition, Oftel is concerned that business consumers may have benefited less than average.

*Oftel welcomes comments and information on the above issues. Comments from consumers and consumer groups are particularly welcome.*

**A4.** MISP agrees that competition is delivering some benefits to consumers but shares Oftel's concern that consumers, particularly first time residential consumers, are not knowledgeable or well informed. (§§ 3.2.9)

**Q5.** Oftel believes that the widespread practice of SIM locking is a concern and consumer information seems poor in this area. Oftel believes that in some other countries consumers benefit from the extra choice that SIM unlocked handsets make possible and the practice in the UK of SIM locking handsets cannot assist the development of competition.

*Do respondents agree with Oftel's impact assessment of SIM locking? Further information on SIM locking practices and consumer behaviour in other countries would be very welcome.*

**A5.** MISP believes that SIM locking is an inevitable consequence of a market in which handset subsidies are provided to post-pay and to unidentified pre-pay customers. Better information about unlocking the phone and the obligation the MNO has to unlock the phone could be provided to customers at the point of sale. (§§ 3.2.12)

### 3.8 Market structure and ISPs

**Q6.** Oftel discussed the declining trend in market shares of ISPs and attributed these trends to the inability of ISPs to offer pre-pay services.

*Do you agree with Oftel's assessment of the position of ISPs? Do you agree with Oftel's assessment that corporate consumers value the services of ISPs? If possible, support your answer with evidence and data.*

**A6.** MISP has set out its views on the position of ISPs in this response (§§ 3.2.17 to 3.2.21). Business consumers value ISPs as only they are equipped to provide a one stop shop for their communication needs including multiple mobile networks, fixed networks, value added services and special billing requirements. ISPs' market shares have diminished and continue to do so. One reason in MISP's opinion is the market structure; another is the failure of Oftel to enforce regulation.

**Q7.** Oftel put forward the view that since the coverage offered by the four GSM networks is now largely equal; the introduction of number portability and the availability of pre-pay packages have meant that barriers to switching mobile networks are reducing; and the total market shares between the four operators have substantially narrowed, the indications are that One2One and Orange have become firmly established in the mobile sector.

*Do you agree that One2One and Orange are now firmly established in the sector?*

**A7.** MISP agrees that One2One and Orange have become firmly established in the market (§§ 3.2.23, 3.3.2). Members are less persuaded of the benefits of MNP than Oftel appears to be. Switching to obtain a better service simply does not happen, there are too many practical barriers. In reality consumers switch to acquire a new subsidised handset where the old handset and the old mobile number are of no value (§§ 3.2.11, 3.2.13).

**Q8.** Oftel put forward the view that, in the future, there will be much more scope for retail service providers to add value as more sophisticated services are developed and m-commerce transactions grow in volume. This being the case, the incentives to abuse market power at the network level to hamper the development of competition in related retail markets will also increase. Of particular concern is the potential for an abuse of market power to have a detrimental impact on the emerging markets for mobile Internet access and portals. But Oftel's view is that there is no evidence of such abuse yet occurring.

*Do you agree with this view? Why?*

**A8.** Members believe that there are considerable opportunities for new services but this is already being locked out by MNOs. There is also considerable scope for abuse and urges Oftel to be proactive in preventing this in the future by preventing operators from foreclosing network access and functionality (§§ 3.4.9-3.4.10)

**Q9.** Oftel put forward the view that the existing mobile operators might anticipate the 3G new entrant towards the end of the period considered by this review.

*Do you agree? What impact on competition might this have?*

**A9.** The new 3G entrant may enter the market towards the end of the period considered by the MMR. MISP's view is that this will have no positive effect on competition. The new entrant will at this time be at a significant disadvantage in the marketplace. It will be unwise to compete on basic voice telephony services where it will be at a material cost disadvantage. Any advanced services provided will be limited by the operator's infrastructure roll out, which is unlikely to be advanced. Where the new operator shares the 2G infrastructure it will be limited to providing the services that can be carried over that infrastructure. MISP believes that 3G and Dolphin should be disregarded for the purposes of this review. (§§ 3.2.6, 3.2.24)

3.9 Profitability and efficiency

**Q10.** Oftel's initial view is that the level of Vodafone's profits is inconsistent with operations in an effectively competitive market. Oftel has also put forward the proposal that differences in accounting profitability can be explained by differences in the relative efficiencies of the mobile operators.

Do you agree with Oftel's analysis? Why? What is your view of the relative efficiencies of the UK mobile operators? What is your view of the future profitability of the UK mobile operators collectively and individually?

**A10.** MISP agrees with Oftel's analysis and, from the information published, that the differences in accounting profitability can be explained by differences in the relative efficiencies of the mobile operators. Members look forward to hearing the outcome from the additional work Oftel has commissioned on the subject.

**Q11.** Oftel has proposed that the market share information, the lack of well informed consumers, the results of the profitability analysis, the observed high static prices for some services, together with the fact that the structure of the market is consistent with a finding that there is some competition yet overall prices are set above the competitive level, supports the view that the mobile sector is not yet effectively competitive.

*Do respondents agree or disagree that this is the case? Why?*

**A11.** For reasons set out in this response MISP shares the view that the UK mobile market is not effectively competitive and, in addition, will not become so during the period considered by the review.

**Q12.** If it is found that the mobile sector is not effectively competitive, Oftel has outlined how it will conclude whether 2, 3 or 4 mobile operators have market power.

*Which conclusion do you believe is the correct one and why? Please consider the evidence required, set out in Table 5 and provide any relevant information that is available to you.*

**A12.** MISP's view from the evidence in the MMR and the arguments put forward in Part 2 of this response that all four MNOs have market power. (§§ 3.3.2 to 3.3.5)

**Q13.** Annex K sets out Oftel's calculation of the cost of capital for the UK mobile operators.

*What is your view on Oftel's conclusions about the appropriate levels for elements in the cost of capital calculation discussed in Annex K?*

**A13.** Insofar as it is qualified to do so MISP agrees with Oftel's cost of capital calculation.

3.10 Future regulation

**Q14.** Oftel has set out the steps that may be taken if it concludes that effective competition does not exist. Oftel has, in those circumstances:

- considered that MI designations are necessary and that existing MI triggered obligations are appropriate but suggested that a useful development might be the supply of unbranded airtime;
- explained that it does not appear appropriate to issue regulatory guidance on the types of wholesale product that the network operators should offer service providers wishing to move into the provision of mobile Internet services; and
- proposed that retail and wholesale price caps may not be an appropriate regulatory response to the problems identified in the mobile sector.

*Do you agree with Oftel's assessment and proposals? Why? Oftel welcomes views on whether the supply of unbranded airtime can be achieved by commercial negotiation within the framework established by the present triggered licence obligations or whether Oftel should consider a change to the present regime.*

**A14.** MISP agrees that MI designations and their triggered obligations remain necessary and will be effective if properly enforced (§§ 3.4.6). Members support the supply of unbranded airtime at cost based prices (§§ 3.4.7) but suggest that there is no evidence to support the belief that the supply can be achieved by commercial negotiation within the present licence obligations. MISP believes that cost based access is an essential prerequisite for competing innovative services (§§ 3.4.5). Oftel should be proactive and issue guidance to ensure that anti-competitive practices do not occur in the provision of mobile Internet and related services.

## 4 PART 2

### 5 Vertical integration and competition in the mobile communication services market

#### 6

*Basil S Yamey, April 2001*

#### 6.1 1. Introduction

**1.1** The Mobile Independent Service Providers Group (of the Federation of Communication Services) asked me to review the role of Independent Service Providers (ISPs) in the mobile telephony market in the United Kingdom, particularly in relation to vertical integration and competition in that market. This is my report.

**1.2** The report is in seven Sections, including this introductory section. Section 2 considers the achievements of ISPs in the face of serious obstacles. In Sections 3 and 4 I review Oftel's position that effective competition is likely to emerge in the network operation industry in spite of the small number of mobile network operators (MNOs) and the insurmountable entry barrier that serves to protect them. In Section 5 I suggest that there is no reason to suppose that the vertical integration of network operation (upstream) and service provider activities (downstream) gives rise to economies or other economic benefits. Section 6 shows that competition in an undistorted downstream market can serve to stimulate or provoke competition in the upstream market. In Section 7 I bring together the implications for regulation of the analysis in the preceding Sections. The conclusion is that, in order to promote competition, both upstream and downstream, and to serve the interests of consumers, Oftel should establish and maintain conditions of undistorted competition in the service provider market such that ISPs and the service provider outlets of network operators compete on an equal footing.

**1.3** This report includes several quotations from the following documents issued by Oftel:

- Fair Trading in the Mobile Telephony Market: Conclusion on Future Competition Policy, following Consultation, April 1997
- Oftel's Review of the Mobile Market, July 1999
- Effective Competition Review: Mobile, February 2001

These publications are referred to by year of publication.

**1.4** I append a short curriculum vitae at the end of the report.

#### 6.2 2. Independent service providers: achievements and present position

**2.1** Oftel has recognised that independent service providers "have played an important role in developing the initial market for voice services" (1999, para 2).

- 2.2** The achievement of the ISPs is shown by simple statistics. Oftel reported in 1999 that "across the last year or so about half of all airtime minutes on the Vodafone network and a quarter of all airtime minutes on the BTCellnet network were supplied to end users through service providers which are independent of the network operators, indicating that customers value the services offered by such companies" (1999, para 2.3).
- 2.3** Oftel has indicated the continuing importance of ISPs, even though the number of active ISPs has tended to fall quite significantly since 1998. "In addition to the in-house service providers of the network operators, there are more than a dozen ISPs with a significant base of customers. Well over 2.5m customers (as at September 2000) rent their mobile phone service from an ISP. Some ISPs have established significant customer bases, and the ISP sector can count many large corporations and institutions amongst its customers, suggesting that ISPs continue to fulfil an important role in the industry and are valued by consumers" (2001, para 2.33).
- 2.4** The achievements of ISPs have to be viewed in perspective. The ISPs have at all times had to compete with tied service providers, i. e. in-house service providers owned and controlled by one or other of the MNOs. The ISPs have had to compete not only with one another, but also with the service providers owned and controlled by one or other of their only sources of wholesale supplies of unbranded airtime or branded airtime packages.
- 2.5** Oftel has described this "key characteristic" of the mobile sector as follows: ISPs "operating in retail markets rely on the vertically integrated network operators for the provision of wholesale inputs, while at the same time competing with those operators at the retail level" (2001, para 2.27).
- 2.6** Oftel is, of course, clearly aware that this creates difficulties for the maintenance of competition: "Oftel has particular concerns about the ability and incentives for network operators to leverage market power at the wholesale level to adversely affect competition in the downstream retail markets" (2001, para 1.17).
- 2.7** Regulation has taken the form of requiring the two longer-established MNOs to supply airtime to ISPs on a non-discriminatory basis, i.e. in broad terms, they must not favour their own tied service providers at the expense of ISPs, and they must not cross-subsidise their own service providers from the profits of their network operations. The two more recent network operators are not subject to these regulatory controls. They are free to operate their own service providers as they see fit and they are not required to supply ISPs.
- 2.8** It has proved difficult for Oftel to ensure that at all times there is a level playing field as between the tied retail outlets of Vodafone and BTCellnet, on the one hand, and the various ISPs on the other. There is, as indicated, no mandatory requirement of a level playing field as far as One2One and Orange are concerned.
- 2.9** Major difficulties confront ISPs and handicap their business activities. Thus the 1999 Review reported the following:
- a) Network operators have structured "their wholesale airtime products in forms which shadow the operators' own retail products". Together with their offers of bonuses, discounts and marketing programmes, this means, in effect, that the network operators largely determine what the ISPs re-sell as retailers. In particular, there has been virtually no supply of unbranded and unpackaged airtime to ISPs (1999, para 2.4).<sup>1</sup>
  - b) There was evidence that BTCellnet and Vodafone had "conducted a margin squeeze by cross subsidising service providers within their Group, with profits taken at the wholesale level. Here again, this has limited the ability of independent service providers to compete with differentiated products" (1999, para 2.5).

- 2.10** Further evidence of the difficulties the ISPs face concerns pre-pay products. Oftel reports that "ISPs do not supply pre-payment products. ISPs have not been able to take advantage of the recent increases in new pre-pay subscribers and have found that their existing customers are churning to pre-pay packages available only from the network operators and Virgin" (2001, para 2.34).
- 2.11** Viewed in the light of such formidable difficulties, the actual achievements of the ISPs are all the more impressive. One can only speculate as to how much more impressive their achievements might have been if Oftel had been able to achieve a level playing field in the retail market at all times and if One2One and Orange also had had to play on that level playing field.
- 2.12** The actual achievements of the ISPs in the face of the handicaps may have inclined Oftel to its strongly-held view that ISPs, if efficient, would be quite able to fend for themselves and prosper without any regulation of the present kind if and when an "effectively competitive market" develops in the network industry. An effectively competitive market is one in which none of the network operators has market power or market influence.
- 2.13** The present Oftel position is that, if there is effective network competition, and if "ISPs are an efficient route to market", then "network operators will supply them" (2001, para 2.35). Oftel took the same position two years earlier: "Competition will mean that the networks will have to use all efficient channels to market and Oftel expects that the networks will wish to continue to work with independent service providers where they provide this..."(1999, para 4.7).
- 2.14** Oftel seems to believe that the fact that ISPs accounted in 1999 for a large percentage of Vodafone and BTCellnet's airtime is evidence for this general proposition (1999, para 4.7, which refers to the then current situation as supporting evidence). However, such a belief is not tenable. Both Vodafone and BTCellnet are under a mandatory requirement to supply airtime to ISPs. Current experience gives no indication about what the two networks would do if they were relieved of that obligation.
- 2.15** In its 2001 Review, Oftel makes some observations about the relative efficiency of ISPs and the networks' tied service providers. It remarks that it "has no evidence that the present generation of ISPs are more efficient than the network operators' in-house retail operations" (2001, para 2.35). But it has not produced evidence going the other way. Indeed, the business success of several ISPs, achieved in spite of the handicaps they have had to contend with, points to their efficiency.
- 2.16** In any case, the only conclusive test of the efficiency of any service provider, whether independent or tied, is its ability to operate profitably in conditions of even-handed (i.e. undistorted) competition. There is no need for Oftel to be concerned with how efficient ISPs are now. The interests of consumers would be best served if it were left to an undistorted downstream market to sort out the more efficient from the less efficient service providers, regardless of whether they were tied or independent.
- 6.3** 3. Effective competition, market power and oligopoly
- 3.1** According to Oftel, in a fully competitive network market "there would be a presumption that, if networks did not wish to use independent service providers as a route to market, then it would not be efficient for them to do so..." (1999, para 4.7). The MNOs' decisions as to channels of distribution would be made solely on the basis of efficiency. Stated in this way, the proposition may be valid. But the proposition has no relevance unless it can be shown that it is at all likely that the mobile network market will become effectively competitive as long as there are only four or five operators and competitive new entry is ruled out.

- 3.2** In its 1997 Statement, Oftel expressed the view that "a market with four players has the potential to function competitively" even if the "four mobile operators remain for the time being protected by an absolute barrier to further market entry". It said that competition between the four operators "was now relatively strong and increasing". It also said that "competition in the mobile telephony market is now flourishing". Nevertheless, Oftel summed up the situation as shown by the evidence and stated "that competition, while in sight is not yet fully effective in the mobile market". It looked forward to a state of affairs coming about in which there would be effective competition and therefore no need for network operators "to distribute their output in a particular way" and to be subject to "mandatory requirements" of a kind that "are not imposed on producers in other sectors of the economy" (1997, paras 2.2, 3.1, 6.1 and 2.4).
- 3.3** Two years later Oftel reported that "there are signs" that effective "competition is emerging", and that it was possible that "at some time in the future" there would be no need for any MNOs to be "subject to the absolute obligation to supply wholesale airtime to [independent] service providers". Oftel did recognise, though, that "the structure of the mobile market and, in particular, the entry barrier arising from the limited supply of spectrum, mean that competition issues could arise again in future even after the market has been found to be competitive..." (1999, paras 4.6 and 4.8).
- 3.4** In its 2001 Review, Oftel finds that there "is no evidence to suggest that competitive pressures have lessened in the intervening period" since 1997. The sector remains "prospectively competitive", though "on balance, the mobile sector is not yet effectively competitive" (2001, paras 2.88 and 2.89). Oftel's current stocktaking exercise is intended to determine, inter alia, whether the sector will become effectively competitive over the next two years or so.
- 3.5** Oftel uses the related concepts of "market power" and "market influence" in its series of examinations of whether there has been, or is likely to be, "effective competition" (or "fully effective competition"). No doubt this particular approach is to be attributed to the specifics of the regulatory regime. This approach means that each network operator has been placed individually in the spotlight to see whether it has market power; and the industry as a whole, as an entity for examination, has not been the main focus of attention. In the latest review there is some suggestion that the emphasis may have changed. This is to be welcomed.
- 3.6** A supplier is said to have market power "if it is able to raise prices above the competitive level for a non-transitory period without losing sales to such a degree as to make this unprofitable". To date, Oftel has decided that Vodafone and BTCCellnet have market power, while Orange and One2One do not. This decision was re-affirmed in March of this year.
- 3.7** The element of artificiality about this approach is clear. Consider an industry consisting of four suppliers that operate in the same product and geographic market. Supplier A cannot raise and maintain its prices above the competitive level unless the competing suppliers B, C and D allow it to do so. But if B, C and D each follows A's raising of its prices, then all four suppliers will be selling at prices above the competitive level. The relevant economic question in these conditions is not whether A has market power, or whether each of the four has market power. The question is whether the oligopolistic structure of the industry is such that it is likely, even if not altogether certain, that prices would be above the competitive level, if not always, then at least for long periods.
- 3.8** In its 2001 Review, Oftel explicitly refers to the mobile network oligopoly and its possible implications:
- (i) Oftel suggests that its evidence indicates that each of the four network operators may be setting prices that "do not necessarily reflect the competitive level. This is of interest to Oftel since the oligopolistic structure of the mobile sector and the high level of interdependence between network operators, combined with high entry barriers, may result in prices for all mobile operators that are above the competitive level" (2001, para 2.73).

- (ii) Again: "OfTel has previously concluded that the structure of the mobile sector is consistent with a range of outcomes from vigorous competition to collusion between the operators. However, the substantial barriers to entry combined with a relatively small number of players are characteristic of an oligopolistic market with high levels of interdependence between firms. A consequence of this market structure is that, even if firms compete to some extent, price competition may be muted since firms will set prices/output to maximise profits subject to how they expect their competitors to react" (2001, para 2.87).

- 3.9** OfTel does not elaborate on what it refers to as the high level of interdependence between firms. The concept of oligopolistic interdependence is well known, however, and it is frequently used in the context of competition policy and its application to individual market situations. The concept itself is simple. Suppose there is an oligopoly consisting of four or five competitors. Each of the oligopolists recognises that if it initiates a competitive price cut and as a result increases its sales materially, its competitors will be bound to follow that price cut; and so they will all be worse off than if no one had made the price cut. Each oligopolist recognises that its pricing decisions cannot be made independently of the usually predictable consequential decisions of the others. Pricing decisions are said to be interdependent, not independent. Recognition of interdependence can bring about a situation in which oligopolists tend to refrain from competing as intensely on price as they would if they acted independently of one another. The outcome is that prices tend to be above the competitive level. This outcome is not, however, due to deliberate collusion. The non-competitive outcome is, as it were, inherent in the logic of the oligopoly situation itself.
- 3.10** OfTel, having identified the critically important features of oligopolistic markets, nevertheless continues to hold the view that a finding (as a result of the current review) that all four operators "have market power now is consistent with the prospect of effective competition in the long term". It holds this view in spite of its appropriate judgement that if all four operators are found, in the present review, to have market power, "this is likely to reflect the oligopolistic structure of the mobile market with absolute barriers to entry at the network level" (2001, §3.12).
- 3.11** What is missing from OfTel's brief observations on the MNO oligopoly is any explanation of how that oligopoly structure can nevertheless be expected to generate the outcome of effective competition. OfTel does not show, or even suggest, that there are special features in the mobile market such that it is at all likely that the completely protected oligopolists would be selling at prices at the competitive level in the foreseeable future. OfTel does not show that there are any special features whose presence precludes or weakens the recognition by each MNO of its interdependence with the other MNOs, or that the recognition of interdependence will not give rise to what is variously called non-collusive "co-ordination" or "alignment" of major decisions such as pricing decisions, or "tacit collusion" or "conscious parallelism".

#### 6.4 4. Oligopoly in the network market

- 4.1** The mobile network industry is an oligopoly. There are four competitors now, and there will be five in due course<sup>2</sup>. Two factors are present that favour non-collusive co-ordination of decisions in the mobile market. These are the entry conditions and the transparency in the market place.
- 4.2** If new entry into an oligopolistic market is easy; it is not likely to be profitable for incumbent firms to attempt to keep their prices above the competitive level. Above-competitive prices and profits will attract new entrants, and the ensuing competition will reduce prices and the profits of the incumbents.

- 4.3** As Oftel has stated repeatedly, barriers to entry into the mobile market are very high. They are indeed insurmountable.
- 4.4** The (downstream) retail market for voice services is transparent. Each MNO has its own service provider outlets, and retail prices in them are visible to all the operators. I understand that, in addition, industry-wide statistics of new subscriptions for each network are available frequently and regularly. It is relatively easy for each operator to infer the measure of success that a rival is achieving with its competitive initiatives.
- 4.5** There is little scope, it seems, for any one of the MNOs to engage in surreptitious competitive behaviour, especially as concerns pricing. It is therefore to that extent less likely for one MNO to introduce a price reduction in the expectation that its competitors will not be able to observe it and respond promptly, and so deprive it of any advantage.
- 4.6** It may be objected that the preceding discussion is unrealistic, and that in fact there has been intense competition in the mobile market. The two more recent operators have succeeded in building up considerable market shares. Further, competition in the pricing of handsets has been a well-known phenomenon.
- 4.7** But what has happened in the last few years is not evidence that the structure of the mobile market does not favour non-collusive co-ordination of decisions. The recent history is not evidence of what is likely to happen when the market structure has settled down. In this connection, Oftel has noted: "The significant narrowing of the total market shares between the four GSM operators suggests that One2One and Orange have become firmly established in the market" (2001, para 2.42).
- 4.8** The market shares of the four network operators have tended to move towards greater equality<sup>3</sup>. This movement itself will tend to reduce the incentive for any one operator to behave independently as to pricing, and so will favour more effective non-collusive co-ordination of decisions.
- 4.9** A simplified example illustrates this point. Suppose there are only two competitors, A and B, in a particular industry. Initially A has 80% and B has 20% of the market. If B makes a price cut, it reduces its profits on its existing volume of sales, but gains profits on additional business won from A if the latter does not match the price cut. A, on the other hand, suffers a reduction in profits on its much larger volume of sales if it decides to match B's price cut<sup>4</sup>. Consider next the different case where A and B have equal market shares. As compared to the previous situation of unequal market shares, B has less incentive to compete by cutting prices, and A has a greater incentive to match B's competitive price cuts, and so to neutralise them. Equalisation of market shares is likely to reinforce non-collusive lessening of competition.
- 4.10** A general qualification is necessary. There is likely to be more price competition in respect of the larger customers in the corporate-customer segment of the downstream market than in the rest of the market. There is, I suspect, more scope for secret price competition in the former segment; and the larger customers are likely to be well-informed, place large orders, have bargaining power and be willing to use it. These are among the features that tend to weaken or prevent non-collusive co-ordination of prices in applicable segments of oligopolistic markets.
- 4.11** It must be made clear that the economic analysis of oligopoly does not rule out the possibility that there can be persistent competitive pressure in an oligopolistic industry and that the prices of its products remain at or near the competitive level. The foregoing discussion does, however, suggest that this is unlikely to be the case in the mobile market over any reasonably long period. The entry of a fifth operator, when the third generation comes to be launched, will almost certainly introduce additional competitive pressure: a four-firm oligopoly, with firms having more or less equal shares, will become a five-firm oligopoly, with one firm starting from scratch with a zero market share. But the entry of a fifth oligopolist will not affect the MNOs' recognition of

oligopolistic interdependence or the tendency towards non-collusive co-ordination of pricing decisions, once the new MNO had established itself in the market. Moreover, unless there were de-stabilising developments affecting the mobile industry as a whole, it is not likely to be in the interests of any of the incumbents to resist strenuously the new entrant's efforts to build up an acceptable market share.

6.5 5. Vertical integration: a source of efficiency?

5.1 As far as I am aware, Oftel has not suggested that the vertical integration of mobile network operation and the operation of service provider outlets as such generates specific efficiency advantages or economies.

5.2 There does not seem to be any reason to suppose that the vertical integration in question reduces transaction costs. There is no reason to suppose that the costs of co-ordinating network operations and the downstream distribution of mobile services are systematically lower (or higher) when the co-ordination is done in-house than when it is achieved between MNOs and an ISP.

5.3 As regards branded goods, manufacturers in some industries find it advantageous to carry out their own retail distribution, chiefly in order to promote their brands more effectively, and to ensure that their products reach the consumer in good condition and in an appropriate shopping environment. However, this consideration does not seem to apply to mobile services. As regards brand promotion, Vodafone and BTCellnet do not seem to have suffered from the re-sale of their branded products by ISPs.

5.4 Another reason why firms may find it profitable to vertically integrate two or more successive stages of production and distribution is to avoid so-called "double marginalization". This is a situation in which the firms in each of the two successive stages, say manufacture and wholesale distribution, have market power and charge prices above the competitive level, i.e. include a monopoly profit in their prices. A firm that has activities in each of the two stages avoids the double marginalization and gains an advantage over non-integrated competitors. This problem, however, does not arise as regards mobile service provision. Entry into the service provider industry is easy. Unless the policies and practices of network operators are such as to impede entry, the service provider industry is highly contestable.

5.5 Similarly, other efficiency advantages of vertical integration that may be present in particular situations do not seem to apply to the mobile telephony situation. For example, there do not seem to be any problems due to the specificity of assets or to access to final consumers: there is no risk that ISPs can "hold up" MNOs.

5.6 In all, there does not seem to be any reason or evidence to suggest that the vertical integration of network operation and downstream service provision as such gives rise to economies or other actual or potential benefits for consumers. This is not, of course, grounds for arguing that vertical integration should not be allowed. Provided that regulation establishes and maintains conditions of undistorted competition in the downstream market(s), it is in the interests of consumers that ISPs and the MNOs' tied service providers should compete for business by offering better value for money, better customer care, and new services (or new combinations of services) to meet the varied and changing requirements of consumers. On the other hand, however, the long-term interests of consumers require that MNOs should not be allowed, through vertical integration, to operate anti-competitive margin squeezes and other anti-competitive practices.

6.6 6. ISPs and network competition

- 6.1** When the first licences were granted to BTCellnet and Vodafone, "these companies were prohibited from supplying services directly to end users and all such services had to be supplied through distinct subsidiary or independent companies" (1999, para 2.3). According to Oftel, the intention "was plainly to facilitate the growth of competition in the provision of services to end users".
- 6.2** Undoubtedly the access of ISPs to supplies of airtime has served to increase competition to end users, to their benefit. ISPs have increased competition by making mobile services more easily accessible, by widening customers' choice of service provider and by increasing the variety of offerings. Some ISPs have been successful innovators. ISPs have also been able to combine mobile services with complementary and related services. I understand that in practice only ISPs can fulfil the role of single supplier of different types of services from multiple networks to large customers. Some ISPs have offered the airtime products of more than one network operator, and in that way have facilitated choice and made it easier for a customer to switch from using one network to another.
- 6.3** The advantages to end users of a market that includes many ISPs stand out when one compares it with a different structure of service provision, namely, one in which all or the great majority of downstream outlets were owned and controlled by one or other network operator, or had long term supply arrangements with one or other of them.
- 6.4** However, the pro-competitive benefits derived from a service provider market that includes ISPs are by no means limited to those obvious benefits noted above. In this context, an important point made by Oftel a few years ago must be recalled. Oftel said: "The prime argument for protecting service provision remains whether or not such protection is necessary to counteract or ameliorate the adverse effects of network market power" (1997, Annex B, para 19).
- 6.5** By making mobile service provision more competitive than it would otherwise be, ISPs may be said to "ameliorate" the adverse effects of network market power. The ISPs ensure that there is more effective competition in the downstream market. What is as important or more important, they also can serve to counteract adverse effects of network market power (or to put it more generally, to counteract the adverse effects of the oligopolistic structure of the network operation industry). However, to date the achievements of ISPs in this counteracting role have probably been modest, given the obstacles they have had to contend with.
- 6.6** The discussion that follows proceeds on the assumption that ISPs are enabled to compete on an equal footing with the tied service provider outlets of all the MNOs. Since this condition (i.e. that there is a level playing field) has not been satisfied in the past, the discussion here is necessarily speculative in the sense that the points being made cannot be tested directly against actual historical experience.
- 6.7** There are several ways in which ISPs may be able to counteract, directly or indirectly, the presence and exercise of market power in the network market and, more importantly, reduce the impact of non-collusive alignment or co-ordination of network operators' pricing and other decisions affecting competition. Five ways are identified for present purposes.
- 6.8** **First**, ISPs that re-sell branded airtime packages bought wholesale from two (or more) network operators make it easier for customers to compare rival offerings. They also enable customers to switch more readily from one network to the other or to use both: the ISP is able to spread the costs of gathering and assimilating information over many customers. This service of providing information about the marketplace is likely to provoke competition among network operators. Further, ISPs would be able to switch between MNOs for unbranded airtime.

- 6.9** **Second**, the more successful ISPs will grow larger. Some are likely to acquire effective bargaining power *vis à vis* network operators, and bring countervailing power to bear against them, thereby provoking competition among them.
- 6.10** **Third**, ISPs are likely to generate "turbulence" in the service provision market, as they are not subject to the control of network operators. There is likely to be more independence in pricing decisions, and so more price competition, than if all or most service provision outlets were owned by network operators or tied to them by long-term supply agreements. The independent competitive behaviour of ISPs is likely to affect the distribution of business among the networks. Such re-allocation of business among the networks, being induced from outside the network industry, is likely to disturb or disrupt non-collusive oligopolistic co-ordination of prices in that industry. Price competition is likely to be contagious.
- 6.11** **Fourth**, ISPs are likely to undermine profitable price discrimination in the upstream market. Suppose each of the network operators finds it profitable to discriminate in its pricing in respect of, say, different categories of end user or different patterns of end use. ISPs are likely to take advantage of resulting profitable opportunities for arbitrage pricing.
- 6.12** **Fifth**, if and when additional network licences come to be issued, the entry of new MNOs will be easier in so far as efficient ISPs are available in the market place.
- 6.13** The preceding discussion shows that an established MNO is likely to have good reasons why it would not want to supply ISPs at all (or only in exceptional circumstances where the MNO has little real choice in the matter e.g. where, say, a large multiple retailing group is the prospective ISP). This would be so even if the MNO believed that some ISPs were more efficient than some of its own tied outlets. An MNO's most efficient route to market is not necessarily the route that is most profitable for it to take.
- 6.14** It may be objected that a particular network operator would be placing itself at a competitive disadvantage if it refused to supply ISPs but its competitors did supply them. Indeed, network operators would gain the potential benefit of a lessening of competition in the downstream market only if they all followed the same policy - in the present context, the policy of not supplying ISPs. But as the MNOs in this respect are all in the same position *vis à vis* ISPs, it is to be expected that they would be likely to adopt the same policy. Each of the oligopolists would be aware that a policy that would increase its profits (provided that the other oligopolists adopted the same policy) would also be attractive to its competitors. It follows that, without there being any collusion, the common situation and the similar expectations of the oligopolists would be likely to lead to the development of a common pattern of vertical integration.
- 6.15** I have already mentioned Oftel's concern about the possibility that network operators may use their position in the upstream market as leverage to extend their position in the downstream market, and so to hamper the development of competition in it. To conclude this section, I revert to that theme.
- 6.16** In its 2001 Review, Oftel observes as follows: "Currently, retail mobile service provision is largely limited to the resale of the network operators' basic services". In the future, on the other hand, "there should be much more scope for retail service providers to add value, as more sophisticated services are developed and m-commerce transactions grow in volume. If the mobile sector is not effectively competitive, the potential for an abuse of market power to have a detrimental impact on the emerging services for mobile internet access and portals, is of particular concern" (2001, para 2.43).
- 6.17** Oftel continues: "In the future, if market power exists at the network level, the potential and incentives to leverage that market power into new emerging retail services (such as the mobile Internet) may be greater than they are today. If a network operator has market power, the operator may be able to devise access charges and implement technology that effectively forces

its customers to use only selected Internet and portal services. The consequent exclusivity of the operator's own portal might be expected to increase its value to advertisers and m-commerce traders, allowing the mobile operator to levy higher commission and transaction charges than would otherwise be the case" (2001, paras 2.34 and 2.44).

**6.18** No comment is required, except to note that the oligopolistic structure of the network industry is likely to be relevant here.

6.7 7. Concluding observations on regulation

**7.1** Oftel has for some years been optimistic that effective competition is likely to develop in the mobile network market within the foreseeable future; and that, as a consequence, it would then be able to remove the special regulatory measures that currently apply to BTCellnet and Vodafone.

**7.2** Its optimism in the past has not been borne out by events. Its present optimism is not warranted in the terms of its own analysis. Oftel has, appropriately, stressed the oligopoly structure of the mobile network industry and the protection of its incumbents from potential new-entrant competition. It has indicated that in those conditions price competition may be "muted", and prices may tend to be above the competitive level. Indeed, muted price competition is not consistent with effective competition<sup>5</sup>.

**7.3** This is not to say, of course, that the general level of prices or of profit margins in the network industry will not be subject to fluctuations due, for example, to changes in the level of demand (itself affected by product innovation). What is being argued here is different: it is that the oligopoly structure will tend to mitigate price competition and affect the behaviour of the oligopolists (for example, their behaviour towards ISPs).

**7.4** Oftel does not, it seems, foresee any significant increase in the number of MNOs, nor any dismantling of, or reduction in, the current insurmountable barrier to new entry. Oftel has not suggested that the oligopolistic "muting" of price competition will become less likely or less effective in the coming years. In those circumstances, Oftel has no reason to be confident that effective competition is in sight or can be expected to come about in the next few years.

**7.5** As long as an oligopoly structure persists in the upstream market, removing the special features of the regulatory regime that are designed to maintain competition in the downstream market would be against the interests of consumers. Instead, there is a strong case for extending the regulatory requirements to all established MNOs, including Orange and One2One. If the present regulatory regime was necessary in the past, it will continue to be necessary for the foreseeable future.

**7.6** If Oftel were to assure ISPs that the regulatory safeguards to prevent distortion of competition in the downstream market would not be removed (and would be enforced effectively) as long as there was an oligopoly structure, protected against new entry, in the network market, this would have the additional merit that it would stimulate investment in downstream activities, and encourage new entrants, including small and medium size enterprises, to join the ranks of ISPs. This would stimulate competition and benefit consumers.

**7.7** It may not be feasible for Oftel to give an assurance about the continuation of regulation until such time as the oligopoly structure of the network industry was replaced by a less concentrated and more competitive structure. A second-best solution might be an official assurance that regulation of the required kind would be continued for a specified period long enough to give ISPs confidence to invest more, and strive harder to expand their businesses and the range of their activities. It could be all the more effective if it were made clear that regulation would not necessarily be removed at the end of the specified period.

- 7.8** A further consideration is that Oftel has tended to overlook the ways in which competition among service providers (in the downstream market) can influence competition among MNOs (in the upstream market). Effective and undistorted competition in the downstream market is likely to stimulate or provoke competition in the upstream market (as explained in Section 6, above).
- 7.9** All in all, it will be necessary for Oftel to establish and maintain conditions to ensure that ISPs and the MNOs' own service provider outlets compete on the proverbial level playing field. It will be necessary to ensure that MNOs make available to ISPs the unbundled elements (which constitute the MNO's offerings) so that ISPs can construct their own value added services and supply them in competition with the MNOs' value added services. The same consideration applies to services to m-commerce traders and as regards content provision.
- 7.10** Regulation that meets these requirements would ensure that the interests of consumers are best served and that scarce spectrum is used most effectively.

**Notes:**

- 1 I note that, in the 1999 Review, Oftel states that it believes "the refocusing of any regulatory obligation on the provision of unbranded airtime should be viewed as a liberalising measure" (1999, para 2.13).
- 2 In this discussion I follow Oftel and do not include Dolphin
- 3 For statistics of market shares, see 2001, paras 2.30 and 2.31.
- 4 To simplify, I assume that neither firm is able to confine its price reductions to only certain of its customers.
- 5 It must be emphasised that the "muting" of price competition referred to does not imply collusion.

6.8 Curriculum vitae Basil S Yamey

- Professor of Economics, London School of Economics (University of London), 1960-1984; now Professor Emeritus
- Fellow of the British Academy
- Member of the Monopolies and Mergers Commission, 1966-1978
- Author of books and articles on applied economics, including the economics of monopoly and restrictive practices.

oooOOooo

**7**