



Mobile call termination

Adoption of Revised SMP Services Conditions following the
Competition Appeal Tribunal's Directions of 2 April 2009

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1. Background

- 1.1 On 27 March 2007, Ofcom published the Mobile Call Termination Statement (“the MCT Statement”). In the MCT Statement, Ofcom:
 - a. identified separate markets for the provision of wholesale mobile voice call termination (“MCT”) in the UK to other Communications Providers by each of Vodafone Limited (“Vodafone”), O2 Limited (“O2”), Orange Personal Communications Services Limited (“Orange”), T-Mobile Limited (“T-Mobile”) and Hutchison 3G (UK) Limited (“H3G”) (collectively, “the MNOs”) in accordance with section 79 of the Communications Act 2003 (“the 2003 Act”);
 - b. determined that each of the MNOs has significant market power (“SMP”) in the market for termination of voice calls on its network(s), also in accordance with section 79 of the 2003 Act; and
 - c. imposed price controls (“the price controls”) on the supply of MCT by each of the five MNOs for four years from 1 April 2007 pursuant to sections 45, 87 and 88 of the 2003 Act.
- 1.2 The SMP services conditions imposing the price controls are contained in Schedule 1 to Annex 20 of the MCT Statement.
- 1.3 On 23 May 2007, H3G appealed to the Competition Appeal Tribunal (“the Tribunal”) under s.192 of the 2003 Act inter alia against Ofcom’s determination in the MCT Statement that it has significant market power (“SMP”) and against the price controls.
- 1.4 On 29 May 2007, British Telecommunications PLC (“BT”) appealed to the Tribunal against the price controls.
- 1.5 On 18 March 2008, the Tribunal referred to the Competition Commission (“the CC”) the specified price control matters arising in H3G’s and BT’s appeals pursuant to s.193 of the 2003 Act.
- 1.6 By judgment of 20 May 2008, the Tribunal dismissed the non-price control matters arising in H3G’s appeal.
- 1.7 On 16 January 2009, the CC notified the Tribunal of their determination of the price control matters.

- 1.8 By judgment of 2 April 2009, the Tribunal decided pursuant to sections 193(6) and 195(2) of the 2003 Act that:
- a. In accordance with the determination of the CC, the remainder of H3G's appeal should be dismissed; and that
 - b. BT's appeal should be upheld to the extent set out in the CC's determination.

2. Directions from the Competition Appeal Tribunal to Ofcom

- 2.1 Pursuant to s.195(4) of the 2003 Act, the Tribunal has remitted the decision under appeal to Ofcom with the following directions:

- “(a) For the 2G/3G MNOs Ofcom shall adopt a price control in which:*
- (i) The glidepaths start at the level of the headline regulated 2G rates in 2006/7.*
 - (ii) The TACs descend in annual reductions of equal percentage each year from the starting points of the glidepaths to arrive, in 2010/11, at the level of 4.0 ppm (expressed in 2006/7 prices).*
 - (iii) The TACs for the first year of the price control period are adjusted so as to take into account the absence of 60 days' notice.*
- (b) For H3G Ofcom shall adopt a price control in which:*
- (i) The pre-adjusted TAC for the first year of the price control period is 8.5 ppm in 2006/7 prices.*
 - (ii) The TACs descend in annual reductions of equal percentage each year from the pre-adjusted first year TAC to arrive, in 2010/11, at the level of 4.3 ppm (expressed in 2006/7 prices).*
 - (iii) The pre-adjusted TAC for the first year of the price control period is adjusted so as to take into account the absence of 60 days' notice.*
- (c) In each case, Ofcom is directed to ensure that the adjustments to take into account the absence of 60 days' notice in the first year of the price control, the calculation of nominal figures (where such calculation is required), the approach taken to rounding and the methodology for deriving the controlling percentages are carried out consistently with the methodology adopted by Ofcom in the March 2007 Statement.”*

2.2 Pursuant to section 195(6) Communications Act 2003, Ofcom has a duty to comply with the Tribunal's Directions. Ofcom therefore now adopts the following revisions to (i) the definition of "Controlling Percentage", (ii) SMP Condition MA 3.4, and (iii) SMP Condition MA 4.4 (as set out in Schedule 1 to Annex 20 of the MCT Statement), such revisions to take effect from 3 April 2009:

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

- (a) ~~15.1%~~ 23.9% for H3G;
- (b) ~~3.2%~~ 9.7% for O2;
- (c) ~~5.8%~~ 12.6% for Orange;
- (d) ~~5.8%~~ 12.6% for T-Mobile; and
- (e) ~~3.2%~~ 9.7% for Vodafone;

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

- (a) ~~11.8%~~ 20.9% for H3G;
- (b) ~~2.5%~~ 8.4% for O2;
- (c) ~~5.3%~~ 11.1% for Orange;
- (d) ~~5.3%~~ 11.1% for T-Mobile; and
- (e) ~~2.5%~~ 8.4% for Vodafone

(ii) **MA 3.4** For the purposes of this Condition, the Target Average Charge means:

(a) for the purpose of the First Relevant Year

- (i) 9.1 pence per minute for H3G;
- (ii) ~~5.7~~ 5.4 pence per minute for O2;
- (iii) ~~6.2~~ 5.9 pence per minute for Orange;
- (iv) ~~6.2~~ 5.9 pence per minute for T-Mobile; and
- (v) ~~5.7~~ 5.4 pence per minute for Vodafone;

(b) for the purpose of the Second, Third and Fourth Relevant Years:
the Target Average Charge in the Base Year multiplied by the
sum of 100% and the Controlling Percentage for that Relevant
Year.

(iii) **MA 4.4** For the purposes of this Condition, the Target Average
Charge means:

(a) for the purpose of the First Relevant Year

- (i) 9.1 pence per minute for H3G;
- (ii) ~~5.7~~ 5.4 pence per minute for O2;
- (iii) ~~6.2~~ 5.9 pence per minute for Orange;
- (iv) ~~6.2~~ 5.9 pence per minute for T-Mobile; and
- (v) ~~5.7~~ 5.4 pence per minute for Vodafone;

(b) for the purpose of the Second, Third and Fourth Relevant Years:
the Target Average Charge in the Base Year multiplied by the sum of
100% and the Controlling Percentage for that Relevant Year.

Annex: Explanatory Statement

- 1.1 For reference, Ofcom sets out in this Annex an explanation of how it has calculated the revisions to (i) the definition of “Controlling Percentage”, (ii) SMP Condition MA 3.4, and (iii) SMP Condition MA 4.4 which are set out in the operative part of this document above.
- 1.2 In accordance with paragraph c of the Tribunal’s Directions, Ofcom has ensured that the adjustments to take into account the absence of 60 days’ notice in the first year of the price control, the calculation of nominal figures (where such calculation is required), the approach taken to rounding and the methodology for deriving the controlling percentages have been carried out consistently with the methodology adopted by Ofcom in the MCT Statement.

The 2G/3G MNOs

(i) The glide paths to start at regulated 2G rates in 2006/07

- 1.3 In accordance with paragraph (a)(i) of the Tribunal’s Directions, Ofcom has ensured that the glide paths start at the level of the headline regulated 2G rates in 2006/7.
- 1.4 As such, the inputs to the calculation therefore remain unchanged from the MCT Statement: 5.63ppm (in 2006/07 prices) for O2 and Vodafone, and 6.31ppm (in 2006/07 prices) for Orange and T-Mobile.

(ii) The annual reductions are of equal percentage: values of X in years 3 and 4 (2009/10 and 2010/11)

- 1.5 In accordance with paragraph a(ii) of the Tribunal’s Directions, Ofcom has ensured that the TACs descend in annual reductions of equal percentage each year from the starting points of the glide paths to arrive, in 2010/11, at the level of 4.0 ppm (in 2006/07 prices).
- 1.6 Taking the starting charges of 5.63ppm (O2 / Vodafone) and 6.31ppm (Orange / T-Mobile) to 4.00ppm (in 2006/07 prices), a real annual percentage reduction of 8.2% (O2 / Vodafone) and 10.8% (Orange / T-Mobile) is required year on year to arrive at a level of 4.0 ppm (2006/7 prices) in 2010/11.
- 1.7 However, the real percentage reductions derived in the previous paragraph result from a calculation undertaken exclusively in real 2006/07 prices. When these prices are stated in nominal terms, inflation must be accounted for and is treated as a geometric term – i.e. as a multiplicative factor. In contrast, the controlling percentages, which make use of a RPI-X formulation, treat inflation as an arithmetic term – i.e. as an additive factor. For this reason, the X in the controlling percentage (RPI-X) is not exactly equal to the real percentage reduction and a small adjustment factor is applied (“the geometric adjustment”). Instead X is equal to the real percentage reduction multiplied by (1+RPI).

- 1.8 As stated in paragraph A18.42 of the MCT Statement, Ofcom used an expected inflation assumption of 2.8% for RPI. Therefore, multiplying the real percentage reductions of 8.2% and 10.8% by (1+2.8%) gives a value of X in the controlling percentage of 8.4% and 11.1% for O2 / Vodafone and Orange / T-Mobile respectively, prior to making any adjustments to recognise the absence of 60 days' notice.
- 1.9 It is these percentages, rounded to 1 decimal place, of **8.4%** (O2 / Vodafone) and **11.1%** (Orange / T-Mobile) which should therefore be stated in the amended definition of the controlling percentages for the third and fourth years of the charge control. The controlling percentage for the second year is modified to take account of the absence of 60 days' notice.

(iii) An adjustment for absence of 60 days' notice: nominal TAC in year 1 (2007/8) and values of X in year 2 (2008/9)

- 1.10 In accordance with paragraph a(iii) of the Tribunal's Directions, Ofcom has ensured that the TACs for the first year of the price control period are adjusted so as to take into account the absence of 60 days' notice.
- 1.11 As for the original charge control specification in March 2007 (see paragraph 9.182 of the Statement), the adjusted TAC in 2006/07 prices for year 1 is calculated as the weighted average of the 2006/07 headline 2G rates (5.63ppm / 6.31ppm) and the first year target rate (5.17ppm / 5.63ppm) – which results from applying a single real percentage reduction of 8.2% / 10.8% – applying a weighting of 2/12 and 10/12 respectively. This results in a weighted average TAC for year 1 of 5.25ppm (O2 / Vodafone) and 5.74ppm (Orange / T-Mobile) in 2006/07 prices.
- 1.12 However, the TAC for year 1 is specified in the SMP conditions as a nominal ppm TAC, rounded to 1 decimal place. As stated in footnote 118 to paragraph 9.239 of the MCT Statement (and described more fully in footnote 269 at paragraph A18.42), Ofcom used an inflation forecast of 3.1% for 2007/08 to convert the year 1 TAC in 2006/07 prices into nominal terms. Applying the same methodology for the redetermination results in a year 1 nominal TAC of **5.4ppm** (O2 / Vodafone) and **5.9ppm** (Orange / T-Mobile).
- 1.13 The remaining step is to specify the value of X for the second year, given the above adjustment to the first year TAC for the absence of 60 days' notice. This is the difference between the year 1 and year 2 TACs, both expressed in 2006/7 prices. The year 1 TACs in 2006/7 prices can be calculated by deflating the year 1 nominal TACs (rounded to 1 decimal place) by the inflation figure of 3.1%. This results in year 1 TACs of 5.24ppm (O2 / Vodafone) and 5.72ppm (Orange / T-Mobile) in 2006/07 prices¹. The year 2 TACs in 2006/7 prices are 4.75ppm (O2 / Vodafone) and 5.02ppm (Orange / T-Mobile) as derived by applying two real percentage reductions of 8.2% /

¹ Note that the year 1 TACs in 2006/07 prices of 5.24ppm and 5.72ppm differ from the figures of 5.25ppm and 5.74ppm stated in paragraph 3.12. This difference reflects the fact that the year 1 TACs are specified in nominal terms rounded to 1 decimal place, and hence the corresponding figures in 2006/07 prices should also reflect that rounding to 1 decimal place, and will not necessarily equal the earlier figures in the calculation prior to deriving the rounded nominal year 1 TACs.

10.8% to the 2006/07 headline 2G rates of 5.63ppm / 6.31ppm. The difference between the year 1 and year 2 TACs, i.e. the real percentage reduction required in the second year, is therefore 9.4% for O2 / Vodafone (5.24ppm down to 4.75ppm) and 12.2% for Orange / T-Mobile (5.72ppm down to 5.02ppm).

- 1.14 Finally, to derive the X in the controlling percentage, Ofcom applied the geometric adjustment factor, i.e. multiplying by (1+2.8%). This results in X for the second year controlling percentage, rounded to 1 decimal place, of **9.7%** (O2 / Vodafone) and **12.6%** (Orange / T-Mobile).

3G-only MNO

(i) Pre-adjusted TAC for the first year (prior to adjustment for 60 days' notice)

- 1.15 In accordance with paragraph b(i) of the Tribunal's Directions, Ofcom set the pre-adjusted TAC for the first year of the price control period at 8.5 ppm in 2006/7 prices.

(ii) An annual reduction of equal percentage: value of X in years 3 and 4

- 1.16 In accordance with paragraph b(ii) of the Tribunal's Directions, Ofcom has ensured that the TACs descend in annual reductions of equal percentage each year from the pre-adjusted first year TAC to arrive, in 2010/11, at the level of 4.3 ppm (in 2006/07 prices). A real annual percentage reduction of 20.3% is required to achieve this year on year, over the three years.
- 1.17 As described in paragraphs 7-8 above, the geometric adjustment of (1+2.8%) should be applied to this real annual percentage reduction of 20.3% to derive the X in the RPI-X controlling percentage. This gives a value of X in the controlling percentage of 20.9%.
- 1.18 It is this percentage, rounded to 1 decimal place, of **20.9%** which should therefore be stated in the revised definition of the controlling percentages for the third and fourth years of the charge control. The controlling percentage for the second year is modified to take account of the absence of 60 days' notice (see below).

(iii) Adjustment for absence of 60 days' notice: nominal TAC in year 1 (2007/8) and value of X in year 2 (2008/9)

- 1.19 In accordance with paragraph b(iii) of the Tribunal's Directions, Ofcom has ensured that the pre-adjusted TAC for the first year of the price control period is adjusted so as to take into account the absence of 60 days' notice.
- 1.20 As for the 2G/3G operators, the adjusted TAC in 2006/07 prices for year 1 is calculated as the weighted average of the 2006/07 rate of 10.70ppm and the first year target rate of 8.50ppm, applying a weighting of 2/12 and 10/12 respectively. This results in a weighted average TAC for year 1 of 8.87ppm in 2006/07 prices. Inflating this figure at 3.1% for 2007/08 results in a year 1 nominal TAC, rounded to 1 decimal place, of **9.1ppm**.

- 1.21 The remaining step is to specify the controlling percentage for the second year, given the above adjustment to the first year TAC, using the steps described at paragraphs 13-14 above. The year 1 TAC in 2006/07 prices is 8.83ppm, derived by deflating the nominal TAC (rounded to 1 decimal place) of 9.1ppm by 3.1%. The year 2 TAC in 2006/7 prices is 6.77ppm as derived by applying a single real percentage reduction of 20.3% to the pre-adjusted year 1 TAC of 8.50ppm in 2006/07 prices. The real percentage reduction required in the second year is therefore 23.3% (8.83ppm down to 6.77ppm).
- 1.22 Finally, the geometric adjustment factor of (1+2.8%) is applied to derive the X in the controlling percentage. This results in X for the second year controlling percentage, rounded to 1 decimal place, of **23.9%**.

Calculation of TACs in nominal prices

- 1.23 Finally, compliance with the charge control requires identifying the nominal TAC in each Relevant Year, given the specification in MA3 and MA4. In accordance with paragraph c of the Tribunal's Directions, Ofcom adopts a methodology consistent with the methodology adopted in the MCT Statement to calculate the nominal TACs.
- 1.24 For example, in the case of O2 / Vodafone:
- The nominal TAC in year 1 is stated directly as **5.40ppm**.
 - The nominal TAC in year 2 is calculated by multiplying 5.40ppm by (1+RPI-9.7%) which, with the corresponding actual RPI equal to 4.0%, equals **5.09ppm**.
 - The nominal TAC in year 3 is calculated by multiplying 5.10ppm by (1+RPI-8.4%) which, with the corresponding actual RPI equal to 0.9%, equals **4.71ppm**.
 - The nominal TAC in year 4 is calculated by multiplying 4.71ppm by (1+RPI-8.4%), to be calculated when the corresponding RPI is known, according to Schedule 1, Annex 1 of the MCT Statement.
- 1.25 The TACs in nominal prices calculated in this way for all MNOs are summarised in Figure 1 below.

Figure 1: Revised table of TACs in nominal pence per minute prices reflecting the Tribunal's Directions of 2 April 2009

	First year	Second year	Third year	Fourth year
Vodafone and O2	5.40	5.09	4.71	TBC
T-Mobile and Orange	5.90	5.39	4.84	TBC

H3G	9.10	7.29	5.83	TBC
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Compliance: Partial Years

- 1.26 Since the revised price controls in this Statement take effect from the third day after the start of Year 3 (i.e., from 3 April 2009), the TACs under the original price controls in the MCT Statement will apply for the first two days of Year 3. The revised price controls in this Statement will apply for the remainder of Year 3. Ofcom will assess compliance for Year 3 against a weighted average of the original TACs and the re-determined TACs, using as the weights the proportion of the days in the year for which each TAC applies.