

# Chapter 1

## Introduction

### Scope of this review and the extent of existing regulation

1.1 This review considers the markets for mobile wholesale voice call termination services.

1.2 Following an investigation by the Monopolies and Mergers Commission (now renamed the Competition Commission - 'the CC') in 1998, which concluded that the termination charges of Vodafone and Cellnet (since renamed O2) were too high in relation to cost and against the public interest, controls were imposed on the termination charges of Vodafone and O2. Their termination charges were immediately brought down to a ceiling of 11.7 pence per minute, which was then reduced by RPI-9% in the each of the subsequent two years until March 2002.

1.3 In 2000/2001, Oftel undertook a review of the controls on Vodafone and O2 and the level of competition in mobile voice call termination in general. At the end of that review, the Director General of Telecommunications ('the Director') proposed that the termination charges of all four mobile operators – Vodafone, O2, Orange and T-Mobile (or One 2 One as it was then known) – be reduced by RPI-12% each year for four years until March 2006. The mobile operators rejected the proposed licence modifications to bring into force these controls. As the Director still believed that controls were necessary to protect consumers, in January 2002 he asked the Competition Commission to investigate whether, in the absence of controls, the termination charges of the four mobile operators would be against the public interest and, if so, whether this could be remedied by way of a modification to their licences.

1.4 In February 2002, the Director, with their agreement, modified the licences of Vodafone and O2 so that the existing controls of RPI-9% on their termination charges were 'rolled over' for one year to March 2003, in order to protect consumers pending the outcome of the CC investigation.

1.5 In its December 2002 report (*Reports on references under section 13 of the Telecommunications Act 1984 on the charges made by Vodafone, O2, Orange and T-Mobile for terminating calls from fixed and mobile networks*), ('the CC report') the CC concluded that:

- the termination charges of the four mobile operators operated against the public interest;
- current termination charges were 30-40% above a fair charge;
- consumers pay too much for calls from fixed lines to mobiles and from one mobile network to another;
- the high cost of termination deters people from calling mobiles; and
- those who make more calls to mobiles, either from a fixed line or another network, unfairly subsidise other mobile owners who mainly receive calls or make on-net calls.

1.6 The December 2002 CC report recommended that:

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- each Mobile Network Operator ('MNO') should reduce the level of the total termination charge by 15 per cent in real terms before 25 July 2003;
  - O2's and Vodafone's charges should be subject to further reductions of RPI-15% between 25 July 2003 and 31 March 2004 and for each of the two subsequent financial years to March 2006; and
  - Orange's and T-Mobile's charges should be reduced by RPI-14% between 25 July 2003 and 31 March 2004 and in each of these subsequent two time periods.

1.7 The CC's report was in line with the Director's conclusions in his statement of September 2001<sup>1</sup>. The Director accepted the CC's recommendation of a one-off cut of 15% in real terms by July. Formal licence modifications to the MNO's licences were put out to public consultation on 28 February 2003 (available at: [www.oftel.gov.uk/publications/licensing/2003/fixmob\\_voda0203](http://www.oftel.gov.uk/publications/licensing/2003/fixmob_voda0203) and [www.oftel.gov.uk/publications/licensing/2003/fixmob\\_orangetmob03](http://www.oftel.gov.uk/publications/licensing/2003/fixmob_orangetmob03)). Those modifications were made by the Director on 4 April 2003. The controls have been carried forward by way of Continuation Notices under Schedule 8 (paragraph 9) of the Act, pending completion of this review. Arrangements for any control of termination charges after the Continuation Notices have ceased to have effect are considered in this market review undertaken by OfTel under the requirements of the new European Directives.

### *Significant Market Power*

1.8 Vodafone and O2 were designated as having significant market power (SMP) under the EC Interconnection Directive (Directive 97/33/EC). As a consequence of that designation, Vodafone and O2 are required to enter into interconnection agreements with other Schedule 2 operators, not to discriminate unduly in the terms of interconnection offered to other networks, to provide the Director with price notifications 24 hours in advance of them taking effect and to forward copies of all interconnect agreements

### **A new regulatory regime**

1.9 A new regulatory framework for electronic communications networks and services entered into force on 25 July 2003. The framework is designed to create harmonised regulation across Europe and is aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers. The basis for the new regulatory framework is five new EU Communications Directives:

- Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services ("the Framework Directive");
- Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities ("the Access Directive");
- Directive 2002/20/EC on the authorisation of electronic communications networks and services ("the Authorisation Directive");

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<sup>1</sup> Review of the Charge Control on Calls to Mobiles - 26 September 2001

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- Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, ("the Universal Service Directive"); and
- Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector ("the Privacy Directive").

1.10 The Framework Directive provides the overall structure for the new regulatory regime and sets out fundamental rules and objectives. These rules and objectives read across all the new directives. Article 8 of the Framework Directive sets out three key policy objectives which have been taken into account in the preparation of the proposals in this consultation document, namely promotion of competition, development of the internal market and the promotion of the interests of the citizens of the European Union. The Authorisation Directive establishes a new system whereby any person will be generally authorised to provide electronic communications services and/or networks without prior approval. The general authorisation replaces the existing licensing regime. The Universal Service Directive defines a basic set of services that must be provided to end-users. The Access and Interconnection Directive sets out the terms on which providers may access each others' networks and services with a view to providing publicly available electronic communications services. These four Directives were implemented in the UK and in other EU Member States on 25 July 2003. In the UK this was achieved via the Communications Act 2003 ("the Act"). The fifth Directive on Privacy establishes users' rights with regard to the privacy of their communications.

### **Implementation**

1.11 The Act provides for functions, powers and duties to be carried out by Ofcom. These include, inter alia, functions, powers and duties flowing from the four EC Communications Directives. Certain existing functions are also transferred to Ofcom. However, Ofcom will not assume full functions under the Act until 29<sup>th</sup> December 2003. Accordingly, transitional arrangements are in place as described in the following paragraph.

1.12 The Communications Act 2003 (Commencement Order No. 1) Order 2003 has been made under sections 411 and 408 of the Act. This order commences certain provisions of the Act for the purpose of enabling the networks and services functions under those provisions to be carried out by the Director until such time as those functions are transferred to Ofcom later in the year. Accordingly, references in those provisions of the Act are, for the present time, to be read as references to the Director.

### **Market reviews**

1.13 The new Directives require National Regulatory Authorities ("NRAs") such as Ofcom to carry out reviews of competition in communications markets to ensure that regulation remains appropriate in the light of changing market conditions. This document is part of the ongoing market review process that the Director had commenced in anticipation of the new regime.

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1.14 Oftel published a national consultation document entitled *Review of mobile wholesale voice call termination markets* ('the May consultation') on 15 May 2003. That document invited comments on the Director's proposals for defining as separate economic markets wholesale mobile voice call termination provided by each of O2, Orange, T-Mobile, Vodafone and Inquam, and wholesale mobile voice call termination provided by '3' to its subscribers. The May consultation also invited comments on the Director's proposals about the state of competition in those markets, and on the remedies which might be applied. The period of consultation closed on 24 July 2003. Having considered responses to the first consultation document, the Director is setting out in the present document his refined proposals in the form of a draft decision; the Notification setting out his proposals, as required by section 80 and section 48(2) of the Act, is at Annex C. Those likely to be affected may make representations within the period ending on **6<sup>th</sup> February 2004**. Arrangements for making representations are explained in Chapter 7.

1.15 Each market review has three parts:

- definition of the relevant market or markets;
- assessment of competition in each market, in particular whether any persons have Significant Market Power (SMP) in a given market; and
- assessment of what are the appropriate regulatory obligations which should be imposed where there has been a finding of SMP (NRAs are obliged to impose some form of regulation where there is SMP).

1.16 More detailed requirements and guidance concerning the conduct of market reviews are provided in the Directives, the Act, and in additional documents issued by the European Commission and Oftel. As required by the new regime, in conducting this review, Oftel has taken the utmost account of the two European Commission documents, as discussed in paragraphs 1.17 and 1.18.

### **EC Commission "Recommendation on relevant product and service markets"**

1.17 The European Commission's Recommendation on markets adopted on 11 February 2003 ('the Commission Recommendation') identified a set of markets in which ex ante regulation may be warranted. The Commission Recommendation seeks to promote harmonisation across the European Community by ensuring that the same product and service markets are subject to a market analysis in all Member States. However, NRAs are able to regulate markets that differ from those identified in the Commission Recommendation where this is justified by national circumstances. Accordingly, NRAs are to define relevant markets appropriate to national circumstances, provided that the utmost account is taken of the product markets listed in the Commission Recommendation (as required by section 79 of the Act).

### **EC Commission "Guidelines on market analysis and the assessment of SMP"**

1.18 The European Commission has also issued Guidelines on market analysis and the assessment of SMP ("the SMP Guidelines"). Oftel has produced additional guidelines on the criteria to assess effective competition<sup>2</sup>. The Director is also

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<sup>2</sup> *Oftel's market review guidelines: criteria for the assessment of significant market power*, Aug 2002

required to take the SMP Guidelines into account when identifying a services market and when considering whether to make a market power determination under section 79 of the Act. The SMP guidelines supplement the OfTel guidelines and replace OfTel's effective competition guidelines issued in August 2000.

### **Obligation to inform the Commission and other NRAs**

1.19 As required by Article 7 of the Framework Directive and sections 50 and 81 of the Act, these draft decisions are also being sent to the European Commission and to other NRAs as, in the Director's opinion, the proposals may affect trade between member states. The Commission and other NRAs may make comments within the consultation period. If the Commission believes that one of the market definitions, or proposals to designate a person with SMP or proposals not to designate any person with SMP, would create a barrier to the single market or if the Commission has serious doubts as to its compatibility with Community law, and issues a notice under Article 7(4) of the Framework Directive, the Director is required by section 82 of the Act to delay adoption of these draft measures for a further period of 2 months while the Commission considers its position.

### **Regulation pending the completion of market reviews**

1.20 The new Directives also allow Member States to carry forward some existing regulation until the market reviews have been completed and new conditions are put in place. As referred to above, Continuation Notices have therefore been issued to relevant communications providers to maintain the effect of certain provisions contained in licence conditions that existed under the Telecommunications Act 1984 prior to 25 July 2003 until, inter alia, the market review process is finished. Further details on this continuation regime can be found at:  
[http://www.oftel.gov.uk/publications/eu\\_directives/cont\\_notices/index.htm](http://www.oftel.gov.uk/publications/eu_directives/cont_notices/index.htm)

### **Final steps**

1.21 By the time the consultation period on this document has closed, Ofcom will have assumed their functions. Therefore, when Ofcom has considered any representations made in response to the present document within the period to **6<sup>th</sup> February 2004**, including any made by the Commission, they may give effect to the proposals, with or without modifications, by making market power determinations and setting conditions. They will do this by publishing a further Notification accompanied by a further and final explanatory statement. Ofcom will, at that time, also give consideration to the discontinuation of current regulation as set out in the continuation notices, which were referred to in paragraph S.3. Thereafter, the markets and the new regulatory remedies will be reviewed at appropriate intervals.

### **Services considered in this review**

1.22 In order for a customer of one public electronic communications network provider (PECN) to be able to speak with the customer of another such communications network provider, the networks need to be connected with each

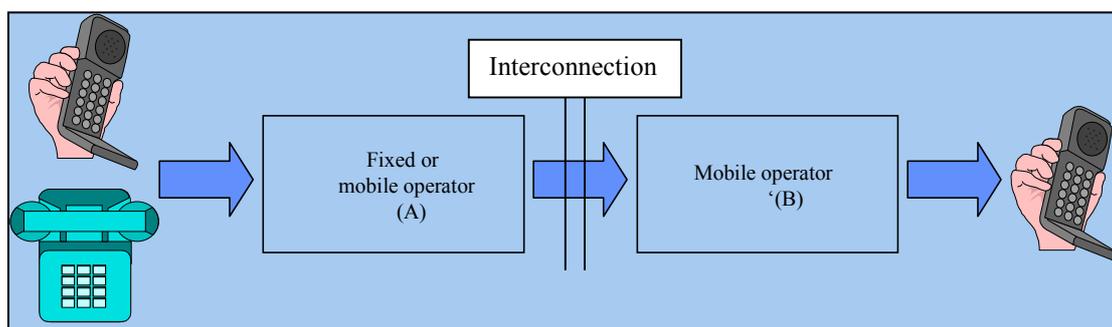
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other. Network access (which in this context refer to mobile voice call termination) amounts to those services that PECN providers need to purchase from each other in order to enable the caller to speak with the intended recipient of the call on another provider's network. These services are referred to as wholesale services as they are sold and purchased by network providers rather than retail customers. Retail customers purchase retail services and these may involve use of a number of wholesale services and one or more network.

1.23 If wholesale mobile voice call termination services were not readily available, retail customers could only communicate with retail customers connected to the same network (known as 'on-net' calling). This would distort competition through reduction in consumer choice and welfare. In order to maximise welfare, network providers need to purchase voice call termination from other network providers so that their customers can contact the customers of the other network provider.

1.24 In the case of wholesale mobile voice call termination, this concerns calls between different mobile networks ('off-net' calls) and calls from a fixed network to a mobile network ('fixed-to-mobile' calls). When a call is made to a mobile phone, whether from a fixed line or from a mobile on another network, the call passes from the originating operator (A) to the terminating operator (B). The terminating operator charges a fee for connecting the call to its customer – the termination charge. This charge is paid by the originating operator and passed on to the caller in the retail price they pay for their call.



1.25 This consultation is only considering wholesale mobile voice call termination. The following mobile services are being covered in separate Ofcom market reviews, as the Commission Recommendation placed them in separate markets:

- access to mobile networks, enabling the provision of retail voice services / calls made by retail customers from mobiles; and
- the wholesale service of international roaming, provided by UK mobile networks to foreign mobile networks, so that foreign mobile customers can use their mobiles whilst in the UK.

### Outline of this document

1.26 The rest of the document is structured as follows:

- Chapter 2 sets out the proposals for the definition of the relevant markets;
- Chapter 3 assesses whether there is SMP in those markets;
- Chapter 4 assesses the detrimental effects of SMP;

- Chapter 5 discusses the options for regulatory remedies;
  - Chapter 6 summarises the proposed charge control;
  - Chapter 7 explains how to make representations;
  - Annexes A, B and D – N provide supporting information and argument;
  - Annex C contains the Notification setting out the Director's draft measures.
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