

Chapter 5

Regulatory remedies

The framework for imposing regulatory remedies

5.1 As explained in Chapter 3, the Director proposes to designate that all six MNOs discussed have SMP in the markets for the provision of mobile wholesale voice call termination services on their networks. The Director therefore needs to consider potential ex ante regulatory remedies to address SMP held in each case. In this chapter the Director has set out the proposed remedies that he believes are needed to address each MNO's SMP.

5.2 Section 87(1) of the Act provides that, where the Director has made a determination that a person has SMP in the market reviewed, he must set such SMP conditions as he considers appropriate and as are authorised in the Act. This implements Article 8 of the Access Directive.

5.3 Paragraphs 21 and 114 of the Commission's SMP Guidelines state that this means that the Director must impose one or more SMP conditions on a dominant provider. Furthermore, the SMP Guidelines state that the imposition of no SMP conditions on a dominant provider would be inconsistent with the new regime. Thus, the Director is under an obligation to impose at least one appropriate SMP condition on any undertaking where SMP is confirmed.

5.4 Section 46 of the Act provides that a person to whom an SMP services condition is applied must be a 'communications provider' or a 'person' who makes associated facilities available and a 'person' who Ofcom has determined to have SMP in a specific market for electronic communications networks, electronic communications services or associated facilities.

5.5 Article 16 of the Framework Directive requires that, where a national regulatory authority determines that a relevant market is not effectively competitive, it shall identify "undertakings" with SMP on that market and impose appropriate specific regulatory obligations. For the purposes of EC competition law, "undertaking" includes companies within the same corporate group (*Viho v Commission* Case C79/73/95 P [1996] ECR I-5447), for example, where a company within that group is not independent in its decision making.

5.6 The Director considers it appropriate to prevent a dominant provider to whom a SMP service condition is applied, which is part of a group of companies, exploiting the principle of corporate separation. The dominant provider should not use another member of its group to carry out activities or to fail to comply with a condition, which would otherwise render the dominant provider in breach of its obligations. For this reason, the Director proposes that the obligations detailed in this Explanatory Statement and Notification should apply to O2, Orange, T-Mobile, Vodafone, Inquam and '3' and any O2, Orange, T-Mobile, Vodafone, Inquam or '3' subsidiary or holding company, or any subsidiary of that holding company, all as defined by Section 736 of the Companies Act 1985 as amended by the Companies Act 1989.

5.7 The Act (sections 45-50 and 87-92) sets out the regulatory obligations that the Director can impose if he finds that any undertaking has SMP. Sections 87 to 92 implement Articles 9 to 13 of the Access Directive and Articles 17 to 19 of the Universal Service Directive. The potential regulatory obligations relevant to this review are:

- the provision of network access;
- no undue discrimination;
- transparency;
- cost orientation;
- cost recovery, including charge controls; and
- cost accounting and accounting separation.

5.8 In his consultation document of 15th May 2003 entitled *Review of mobile wholesale call termination markets* (the 'May consultation'), the Director also considered measures that could be taken to remove the underlying problem of a lack of competitive pressure in the relevant markets. Potential alternative remedies, including technical solutions, were considered and comments sought on their viability. At this time, the Director does not consider that any of these alternative remedies is able to generate the necessary competitive pressure in the relevant markets. The Director's views on these alternative remedies are discussed in more detail in Annex D.

5.9 Recital 27 of the Framework Directive provides that ex ante regulation should only be imposed where competition is not effective and where competition law remedies are not sufficient to address the problem. In order to provide a full analysis, the Director has, therefore, considered the option of no ex ante regulation, and whether it would be sufficient to rely on competition law alone, while noting the obligation referred to in paragraph 5.3. Annex N discusses the need for ex ante or ex post regulation.

5.10 Section 4 of the Act imposes a duty on the Director, in carrying out his functions, to act in accordance with the six Community requirements set out in that section. This implements Article 8 of the Framework Directive. The Director, in considering for the purposes of this market review whether to propose any SMP conditions, has considered all of these requirements. In particular, he has considered the requirement to promote competition in relation to the provision of electronic communications networks and electronic communications services. The Director has also considered the requirement to encourage network access and service interoperability for the purposes, inter alia, of securing efficient and sustainable competition in the markets for electronic communications networks and services, and for securing maximum benefits of customers of communications providers.

5.11 In addition, in the anticipation of the coming into force of section 3 of the Act on 29 December 2003 by virtue of the Office of Communications Act 2002 (Commencement No. 3) and Communications Act 2003 (Commencement No. 2) Order 2003, S.I. 2003 No. 3142 (C. 125), the Director considers that, in carrying out the above-mentioned functions and acting in accordance with the six Community requirements, he has also performed his general duties under section 3 of the Act. Namely, the Director considers that furthering the interests of citizens in relation to

communications matters and of consumers in relevant markets, where appropriate by promoting competition, are matters forming part of his proposals and an outcome he also expects to achieve by the proposed remedies. In particular, he has had regard to certain matters in section 3(4) of the Act and the interests of consumers in respect of choice, price, quality of service and value for money, as required by section 3(5) of the Act (see e.g. paragraph 4.24 above). In this context, the Director also notes that section 3(6) of the Act requires him to, in carrying out functions mentioned in section 4(1) of the Act, prioritise his duty under section 4 of the Act if any of his general duties conflict with it.”

5.12 Further more, as well as being appropriate (section 87(1)), each SMP condition must also satisfy the tests set out in section 47 of the Act, namely that each condition must be:

- a. objectively justifiable in relation to the networks, services or facilities to which it relates;
- b. not such as to discriminate unduly against particular persons or a particular description of persons;
- c. proportionate to what the condition is intended to achieve; and
- d. in relation to what it is intended to achieve, transparent.

5.13 There are also additional matters to consider in respect of network access conditions, set out in section 87(4) of the Act, including the feasibility of the provision of the proposed network access, and additional requirements for network access pricing conditions, set out in section 88 of the Act and dealt with in Chapters 4 & 6. It is the Director’s view that the proposals contained in this chapter satisfy the relevant requirements specified in the Act and relevant European Directives. This view is explained in detail in the following paragraphs.

Aims of the conditions being proposed

5.14 Mobile call termination needs to be purchased by all PECN providers (i.e. Fixed Network Operators, or ‘FNOs’, and MNOs) from all MNOs, to ensure that customers can call anyone on any mobile network. In the absence of wholesale call termination, the extent of a network would also be the limit of its reach and any customers connected to such a network would only be able to speak with other customers connected to that same network.

5.15 As explained in Chapter 2, current technology does not allow the termination of a call to a mobile other than on the network of the MNO to which the called party subscribes. Hence, each MNO has a 100% share of the voice calls terminating on its network. A PECN provider is therefore reliant on the MNOs for the completion of calls to their subscribers. Without the provision of call termination services on fair and reasonable terms, competition could be restricted.

5.16 For that reason, the larger, established MNOs (the ‘four MNOs’)²³ should be required to provide wholesale mobile voice call termination services to PECN

²³ Vodafone, O2, Orange and T-Mobile. For reasons discussed later in this chapter, H3G (‘3’) and Inquam are excluded from this group of MNOs.

providers requesting such services. Requiring the provision of access on fair and reasonable terms ensures that competition develops to the benefit of consumers.

5.17 It is also important to ensure that the terms on which the four MNOs make call termination services available are fair and not unduly discriminatory. As discussed in Chapters 2 and 3, in the absence of regulation, as a result of their dominance in the relevant markets, MNOs have the ability and incentive to set excessive call termination charges. They also have the ability to discriminate - through the terms or charges under which termination is offered - between specific PECN providers or groups of PECN providers. Rules designed to prevent exploitative pricing and prevent unduly discriminatory behaviour are therefore extremely important. Regulatory remedies that prevent such undue discrimination, along with transparency obligations to support such remedies, must be designed to prevent any such potential abuses of SMP.

Remedies considered

5.18 In Chapter 6 of the May consultation, the Director set out four options for different regulatory remedies to be applied to Vodafone, O2, Orange and T-Mobile in respect of 2G and 3G mobile voice call termination services. These were:

- Option A

No ex ante regulation.

- Option B

A requirement to secure transparency through publication of charges and prior notification of charge changes.

- Option C

Option B plus a requirement to make transparent the charges, terms and conditions through publication of a reference offer; a requirement to provide mobile voice call termination on fair and reasonable terms; a requirement not to unduly discriminate in the provision of the service; and imposition of charge controls.

- Option D

Option C plus a requirement to maintain cost-accounting systems; a requirement to set prices on the basis of forward looking long-run incremental costs; and a requirement for separate accounting systems.

5.19 In Chapter 6 of the May consultation, the Director also set out four options for levels of regulation for 3's 2G and 3G mobile voice call termination services. These were:

- Option AA

No ex ante regulation.

- Option BB

A requirement to set charges on the basis of forward looking long-run incremental costs.

- Option CC

Option BB plus a requirement to secure transparency through publication of charges and prior notification of charge changes; a requirement to make transparent the charges, terms and conditions through publication of a reference offer; a requirement to provide mobile voice call termination on reasonable request and on fair and reasonable terms; and a requirement not to unduly discriminate in the provision of the services.

- Option DD

Options BB and CC plus a requirement to have cost-accounting systems in place; a requirement for separate accounting systems; and the imposition of charge controls.

5.20 Further, in Chapter 6 of the May consultation, the Director set out four options for different levels of regulation of Inquam's mobile voice call termination services:

- Option AAA

No ex ante regulation.

- Option BBB

A requirement to secure transparency through publication of charges and prior notification of charge changes.

- Option CCC

Option BBB plus a requirement to make transparent the charges, terms and conditions through publication of a reference offer; a requirement to provide mobile voice call termination services on reasonable request and on fair and reasonable terms; a requirement not to unduly discriminate in the provision of such services; and the imposition of charge controls.

- Option DDD

Option CCC plus a requirement to maintain cost-accounting systems; a requirement to set charges on the basis of forward looking long-run incremental costs; and a requirement for separate accounting systems.

5.21 The Director assessed each of these options against the criteria and tests set out in what was then the Communications Bill (now the Act).

5.22 The Director's regulatory option appraisal led him to propose that:

i) Option A was the most appropriate and suitable regulatory response for 3G services in the markets for wholesale mobile voice call termination on the networks of Vodafone, O2, Orange and T-Mobile;

ii) Option C was the most appropriate and suitable regulatory response for 2G services in the markets for wholesale mobile voice call termination on the networks of Vodafone, O2, Orange and T-Mobile;

iii) For 3G services, Option AA, and, for 2G services, Option BB were the most appropriate and suitable regulatory responses to address the SMP held by '3' in the market for mobile voice call termination on its network; and

iv) Option BBB was the most appropriate and suitable regulatory response to address the SMP held by Inquam in the market for mobile voice call termination on its network.

5.23 The Director asked for views on his proposals.

Responses to the May consultation

5.24 The Director received 14 responses to the May consultation. These included 13 non-confidential versions that can be found at:

<http://www.oftel.gov.uk/publications/responses/2003/ctm0503/index.htm>

5.25 The views of respondents can be divided into two broad groups: Industry groups, fixed network operators and consumer groups generally supported the Director's proposals, whilst the six MNOs expressed strong opposition. Within each of these two groups, there were some differences of opinion on market definition, SMP and the details of the proposed remedies - these views are summarised in Annex B.

5.26 The Director's views on the points raised by the respondents on his proposals for regulation are set out below. This includes a discussion of the Director's position regarding bilateral agreements. Responses to detailed points regarding the charge control model itself are discussed separately in supporting annexes.

The Competition Act 1998

5.27 Several respondents commented on the ex post powers available to the Director, arguing that his powers in the Competition Act 1998 should be sufficient to ensure that anti-competitive behaviour is deterred. The Director has considered this point and has concluded that the application of ex ante regulation in the relevant markets is still justified. Annex N sets out the Director's view on ex post versus ex ante regulation.

The Director's views on responses to the May consultation

Powers to set remedies and alternatives to proposals

5.28 The four MNOs have all suggested that alternatives exist to the proposed regulation, citing both technological and commercial remedies. The Director has reviewed these alternatives and has concluded that none of the solutions discussed is currently likely to be effective. These alternative proposals are discussed in more detail in Annex D. The success of most of these remedies is dependent on a change in the behaviour of both callers to mobiles and mobile subscribers. In particular, callers to mobiles would need to become better informed about the relative prices for calling different mobile networks, and to respond to this information by making more calls to networks with lower termination charges and fewer calls to networks with higher termination charges. This would induce mobile customers to become more responsive to the price of inbound calls, so they would be prepared to incur some cost to enable callers to call them more cheaply. If such a change of behaviour took place, the MNOs themselves would have an incentive to compete on inbound call charges. Thus, in order for these remedies to be effective it is necessary for there to be a change in consumer behaviour along the line of the type of change that would of itself remove the problem and the need for a remedy. The key question is whether an alternative to the Director's proposals would play any part in changing consumers' information set and behaviour, so that callers were more aware of the prices for calls to specific networks and mobile customers were more responsive to the prices of inbound calls in choosing their mobile network. In the Director's view, none of the proposed remedies would by itself quickly change consumers' behaviour in this way, but each might have a part to play in focusing more attention on inbound call charges and thus contributing to a gradual change in behaviour.

Provision of network access

5.29 In their respective responses, Vodafone, Orange and O2 all opposed the proposed network access condition set out in the May consultation (proposed SMP conditions MC1 and MD1). Vodafone argued that as there is no evidence of a refusal, there is likely to be no concern, adding that existing regulation (such as competition law) already obliged MNOs to provide access. Orange and O2 both considered the access remedy to be unnecessary. Orange stated that there is no reason to believe that commercial incentives would not be sufficient, whilst O2 suggested that the existing interconnect requirements meant that a third party could gain access via BT. Further, O2 explained that an additional power to ensure access was provided for by Article 5 of the Access Directive. O2 also added that it considered the definition used in the condition to be wider than the relevant market.

5.30 As discussed in paragraph 5.15 above, other PECN providers are reliant on access to the wholesale mobile voice call termination services provided by MNOs. The Director considers that the four MNOs have the ability and have, or could develop, the incentive not to offer access on fair and reasonable terms (for example, by setting an unfair or unreasonable credit vetting policy). The absence of an obligation on the four MNOs to provide mobile voice call termination services on fair and reasonable terms could impede competition, for example by restricting the ability of other PECN providers to use such services by means of setting unfair

terms and conditions such as an unreasonable credit vetting requirement (see paragraphs 5.31 and 5.32 below).

5.31 The Director recognises that the imposition of unfair or unreasonable demands for financial securities on PECNs seeking to purchase call termination services from MNOs can impede competition in downstream markets. In July 2003, the Director issued a Direction in respect of Vodafone's credit vetting clause²⁴, which related to an interconnection dispute between Vodafone and both ntl and MCI. The Director understands that, although the requirements of this Direction have been accepted by Vodafone, they have not yet been formally entered into the interconnect contracts that exist between Vodafone and both ntl and MCI.

5.32 For the avoidance of doubt, the positions articulated by the Director in both that Direction and the Explanatory Memorandum that accompanied it remain relevant in the new regulatory framework. The Director is of the opinion that the credit vetting of PECNs is reasonable in principle, and that the imposition of an appropriate credit vetting policy, which prevents bad debt from occurring in the first place, is more efficient than taking steps only after the bad debt has been incurred. However, a balance needs to be struck between protecting the legitimate commercial interests of the SMP operator and ensuring that action to protect those interests does not harm competition.

5.33 PECN providers could still interconnect via BT, but this would be an inefficient solution as it uses resources to introduce an unnecessary leg in the termination process. The exclusion of such an obligation would mean that cases of access being refused or not being provided on a fair and reasonable basis would have to be examined on a case-by-case basis, i.e. it would have to be considered in each case whether a network access obligation should exist at all, whereas an ex ante regulation provides more certainty and is less reliant on individual complaints. As timely intervention would be indispensable in these cases, the Director also considers that such an ex ante obligation would constitute an appropriate complement to competition law. Furthermore, the Director does not consider the inclusion of an access obligation to be onerous for MNOs, yet provides regulatory certainty for other PECN providers. It is therefore proportionate and appropriate.

5.34 Whilst the Director notes that Article 5 provides him with powers to ensure access, it would not seem necessary or appropriate to use powers under section 73 of the Act (which implements Article 5 of the Access Directive), given that powers to set SMP conditions are available to the Director which are appropriate for him to use.

5.35 The position as regards the four MNOs in 2G and the proportionality of a network access obligation is well established. However, it is less clear in the case of the new operator '3'. In considering the proportionality of remedies for '3's SMP, the Director has paid close attention to its nascent state of development. For this reason the Director considers that it is likely to be more proportionality to refrain from imposing a network access obligation on '3' at this time in the circumstances

²⁴ <http://www.oftel.gov.uk/publications/licensing/2003/credvet0703.htm>

currently prevailing. Where the four MNOs are in a similar position, i.e. in their own nascent 3G networks, the Director has currently adopted a similar approach.

5.36 In relation to Inquam, it has a very small customer base and the vast majority of the calls terminating on its network are on-net, therefore it provides voice call termination to operators other than itself on very limited occasions. An access obligation on Inquam would therefore seem disproportionate. The Director therefore considers that a network access obligation would be inappropriate and disproportionate for Inquam at this time.

No undue discrimination

5.37 In their responses, Orange, O2, T-Mobile and Vodafone all took the view that a non-discrimination obligation is unnecessary and that its application is unclear. The Director disagrees, as opportunities exist for an MNO to discriminate in a manner that would unfairly disadvantage another PECN provider. For example, whilst charge controls are proposed, they do not set individual charges for termination, but average charges to be met over a specified period. An MNO could therefore unduly discriminate between PECN providers by applying different individual charges.

5.38 Types of discrimination might include:

- (a) MNO discriminating between other MNOs and FNOs;
- (b) MNO discriminating between FNOs;
- (c) MNO discriminating between other MNOs; or
- (d) MNO discriminating between itself and other MNOs and/or FNOs.

5.39 The Director has recognised the potential for type (a) discrimination, and that it may not raise concerns, by setting separate caps for termination charges for fixed-to-mobile and off-net (mobile-to-mobile) calls (see the discussion on bilateral agreements below for further details). Discrimination of type (b) would be likely to raise concerns about distortion of competition between FNOs, although the MNOs' incentives to behave in this way are not straightforward. Type (d) discrimination concerns the vertical relationship an MNO has between itself and its retail arm and is the subject of investigation by Oftel (see paragraph 5.42 below). Type (c) discrimination is perhaps of the greatest concern to the Director. As described in paragraph 5.37 above, an MNO may apply different charges for termination over a period and still meet the requirements of the proposed charge control. Such behaviour could target new entrants, such as '3'.

5.40 The Director considers that a definitive list of prohibited behaviour cannot be provided in advance, as this would fetter his discretion in the event of any potential future breaches of the obligation. However, the obligation would only apply in cases where the discrimination is *undue*. Discriminatory behaviour would therefore not be considered in breach of the proposed obligation if objectively justified.

5.41 The Director considers that such a non-discrimination obligation would introduce essential *ex ante* regulation in the markets in question, thereby providing certainty in the relevant markets and reducing the likelihood of impairing fair and effective competition to the detriment of consumers, whilst not placing an onerous requirement on the MNOs in question.

5.42 SPC Network (responding on behalf of fixed alternative networks) argued that a non-discrimination obligation should be supported by a margin squeeze test. At present, the Director considers this to be an unnecessary additional obligation, as such a test specifically addresses concerns about vertical discrimination between the MNOs' own businesses and FNOs. However, at the time of writing, OfTel is looking into a possible case of margin squeeze concerning the MNOs as an own-initiative investigation under the Competition Act (http://www.oftel.gov.uk/publications/comp_bull/cases/cw_615.htm). The Director is investigating whether the prices charged by the MNOs for the delivery of non-PSTN calls to mobiles for retail business customers are at a level which represents a margin squeeze vis-à-vis the wholesale rate for mobile call termination.

5.43 Whilst the Director does not currently consider that a no undue discrimination obligation should be supported by a margin squeeze test, the outcome of this investigation will inform the Director's view as to whether or not remedies such as a margin squeeze test obligation would be necessary in the future. This position also applies to Energis' argument that a non-discrimination obligation should apply to the supply of mobile voice call termination services by MNOs to their own businesses, as the issue is the same.

5.44 Energis has also argued that a non-discrimination condition should be placed on both Inquam and '3'. The Director does not believe that the application of a non-discrimination obligation would be proportionate in either case. In the case of '3' the Director has paid close attention to its nascent state of development. The Director also notes that, as regards type (c) discrimination, it has a small (albeit growing) subscriber base and consequently a much larger proportion of off-net traffic than the other MNOs. Whilst MNOs may have an incentive to weaken '3's position in the retail mobile market by charging '3' very high termination rates, the Director would not expect '3' to have the same interest as most of its traffic is off-net. As a consequence, in the Director's view '3' would not have the same incentives as the other MNOs to discriminate between MNOs.

5.45 In the case of Inquam, it has a very small customer base and the vast majority of the calls terminating on its network are on-net. Therefore, it provides voice call termination to operators other than itself on very limited occasions. Furthermore, as the Director is not proposing to require Inquam to provide access to its voice call termination services and is proposing that the prices for its services are published in advance, the application of a no undue discrimination condition would appear to him to be disproportionate. The treatment of Inquam is discussed further in paragraphs 5.110 to 5.113 below.

Transparency - Requirement to notify charges

5.46 In the May consultation, the Director proposed a 28 day advance notification period for changes to charges for 2G mobile voice call termination for Vodafone, O2, Orange and T-Mobile, and such an obligation for Inquam in the market for mobile voice call termination on its network. In its response on behalf of the fixed alternative networks, SPC Network requested that the Director instead set a 90 day notice

period, as a 90 day notice period would be consistent with the Director's position in other markets.

5.47 The Director considers that 28 days is broadly consistent with current contractual terms and gives sufficient time for PECN providers to adapt to changes to wholesale charges. A key concern of the Director is that the pass-through of savings gained from the charge control could be delayed by a lengthy period of notification. With these points in mind, the Director does not consider that the argument raised by SPC Network is a valid reason for proposing a 90 day period, and that it would be disproportionate and inappropriate to propose such a period in this case.

5.48 In its response, T-Mobile took the opposite view to SPC Network by arguing that a 28 day notice period is unjustified, as it prevents MNOs from changing charges in a shorter time frame. However, the Director has proposed a notice period for this very reason: a period of less than 28 days, or no notice period at all, would not offer sufficient transparency to other PECN providers and could therefore detrimentally affect competition by restricting a PECN provider's ability to take account of charge changes.

5.49 Orange's view was that the need for transparency through a price publication obligation should only apply to fixed to mobile charges. The Director does not agree with this view, as his rationale for price publication is that it assists with monitoring for potential anti-competitive behaviour and gives advance warning of charge changes to PECN providers who are purchasing wholesale services. As this rationale is valid for both fixed and mobile operators, there is no valid justification for only applying this obligation to the charges for terminating fixed voice calls

Transparency - Requirement to publish a reference offer

5.50 Orange, O2, Vodafone and T-Mobile have all argued that the proposed requirement to publish a reference offer is an unnecessary and over-prescriptive obligation.

5.51 Vodafone also raised concerns that the obligation would prevent it from varying the conditions, where appropriate, of a particular contract.

5.52 The Director acknowledges that the Reference Offer ("RO") proposed in the May consultation may be over-prescriptive. This was raised in discussions between the Director and some MNOs.

5.53 In some cases, an RO is justified where there are concerns regarding bundling. However, the Director does not consider this to be applicable in the markets examined. Instead, the key driver behind the requirement for an RO obligation is the need to support a no undue discrimination condition. An RO would provide transparency of the treatment of different PECN providers to ensure that there is no undue discrimination between parties. Such transparency being provided on a case-by-case basis cannot be relied upon, as by the very nature of unpublished interconnect agreements, a PECN provider is not able to tell whether it has been unduly discriminated against and bring it to the Director's attention.

5.54 The Director recognises that key information in the MNOs' standard interconnect agreements cannot be published, for reasons of network security or commercial confidentiality. In taking account of this, the Director proposes that instead of publishing an RO, the four MNOs submit to him copies of any new or revised interconnect agreements signed with other PECN providers.

5.55 This obligation would provide the transparency needed to support a no undue discrimination obligation, without raising concerns of network security or commercial confidentiality.

5.56 An obligation in the format now proposed also permits the monitoring of other obligations, such as the charge control.

5.57 SPC Network supported an obligation to publish a reference offer, advising the Director that alternative networks have:

'experience of MNOs being able to play one Altnet [alternative network] off against another, for example over financial security requirements. The publication of a RO would prevent this practice and allow for whole industry negotiation.'

5.58 SPC Network has requested that, in addition to an RO obligation, each MNO should also be required to publish an 'internal' reference offer (i.e. the terms under which each company provides termination to itself), in order to be consistent with the Director's proposals in other markets. At present, the Director does not consider this an appropriate obligation.

Proposed charge controls

5.59 In Chapter 6 of the May consultation, the Director proposed an RPI-X charge control on the four MNOs' 2G voice call termination services, in response to the risk of excessive prices being set due to a lack of competition in the market. Details of the control are set out in Chapter 7 of the May consultation.

5.60 In their respective responses, Vodafone, Orange, T-Mobile and O2 all opposed the proposed charge control conditions set out in the May consultation (proposed conditions MC3, MC4, MD3 and MD4).

5.61 The arguments raised against the imposition of charge controls cover a range of issues, the majority of which are discussed in other chapters / annexes of this document. The following summarises the main arguments raised:

- a) The Director's justification for a charge control in terms of the effects in the absence of ex ante regulation is unwarranted. Some MNOs have suggested that they do not have the ability to raise prices, due to competitive pressures. As set out in Chapter 3 of this explanatory statement, the Director disagrees with this assertion. The ability of the four MNOs to raise prices, and the adverse effects that arise from this, are discussed in Chapters 3 and 4.
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- b) It has been argued that charge controls that reflect costs are not economically efficient, and that a Ramsey pricing approach should instead be adopted. The Director does not disagree that setting a fair charge in accordance with Ramsey principles could minimise the loss in economic efficiency introduced by the departure from marginal cost pricing due to the presence of common costs. However, he considers that there are strong reasons to believe that such a termination charge cannot be arrived at. This is dealt with briefly in Chapter 6 and discussed in full in Annex K.
- c) Orange has argued that flaws exist within the Director's cost benefit analysis ('CBA'). The Director does not agree with Orange's assertion. Annex L sets out the Director's CBA in full.
- d) Orange has also argued that a charge control does not promote competition. The Director disagrees with this argument, as by preventing excessive charges being set the charge control, amongst other things, protects other PECN providers purchasing 2G termination services from behaviour such as anti-competitive price discrimination (see paragraphs 4.52 – 4.55 of Chapter 4).
- e) MNOs have argued that it is wrong for the Director to imply that perfect competition is required for a 'waterbed' effect. The Director disagrees and his views on this have been set out a number of times prior to this document. Further discussion can be found in Chapter 4.
- f) It has been argued that there is a lack of quantitative evidence to support the Director's analysis of detriments. In fact, the Director has undertaken a significant amount of work to quantify the welfare gains of imposing a charge control. These are discussed in more detail in Chapter 4 (see paragraph 4.16).
- g) The 'costs' of imposing a charge control have been raised by MNOs, in particular by T-Mobile. Examples suggested include higher outgoing prices, higher upfront charges and increased switching costs. The Director notes these arguments and his rejection of them is set out in Chapter 4.
- h) T-Mobile argued that the potential regulation of 3G limits the willingness of MNOs to invest in its development, suggesting that levels of invest are limited where uncertainty of whether prices will be regulated in the future exists. As the Director advised in the May consultation, he currently has no plans to regulate 3G services. The reasoning behind this view is set out in paragraphs 5.109 – 5.113. It is impossible to state categorically what regulation would apply to T-Mobile's 3G services in the future, as they have yet to be offered on a wide-scale commercial basis.

Bilateral agreements of mobile-to-mobile voice call termination charges

5.62 In the May consultation, the Director examined Vodafone's suggestion that an alternative to the charge control, albeit restricted to mobile-to-mobile off-net calls, might be to impose on the MNOs the obligation to engage in bilateral negotiations to set termination charges. The rationale behind this proposal is that negotiations between a pair of MNOs would be effective in constraining the level of off-net voice termination charges because they would alter the incentives faced by the MNOs in setting those charges.

5.63 Vodafone's argument is that, if an MNO determines its voice call termination charges unilaterally, it has the incentive to set its charges at a high level. This is due to the fact that it expects:

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- a) to generate profits on voice call termination services to fund competition in the retail market;
 - b) to increase the costs of its rival MNOs in providing off-net outbound calls; and
 - c) that, if it does not set its own off-net voice termination charges at a high level, the other MNOs will set their charges at a high level, leaving it at a competitive disadvantage.

5.64 Vodafone claims that if, instead, reciprocal voice call termination charges are set through bilateral agreements, an MNO cannot gain an advantage over the other MNOs by altering its termination charges, as it can only change its charge by agreeing a variation to the agreement with each of the other MNOs. Hence, if an MNO tried to increase its voice call termination charges, the termination charges of its competitor would also increase simultaneously and, thus, would also affect its cost of terminating calls on its rivals' networks. This removes the incentive for any MNO to raise its voice call termination charges to gain competitive advantage and provides each MNO with the incentive to set its termination charge at a level that maximize consumption of its services. Hence, MNOs would set termination charges at cost to maximize consumer demand and would capture as much as possible of the consumer surplus through fixed charges.

5.65 Vodafone argued that the result of its suggested remedy is supported by the economic literature on the subject.

5.66 Vodafone has not proposed a similar remedy for fixed-to-mobile termination charges, because the incentives faced by the MNOs in determining these charges are different and bilateral negotiations with FNOs are not going to alter them.

5.67 The Director examined the relevant economic literature and reached the conclusion that it would be unsafe to rely on it. It is still a developing literature, whose conclusions are not unambiguous (there are also models that yield above-cost termination charges) and which relies on a number of simplifying assumptions.

5.68 The Director showed how, if some of the simplifying assumptions are relaxed, the results of these models change markedly. For example, if the assumption that there is symmetry of traffic flows between each pair of MNOs is dropped (currently traffic between MNOs is not in balance), the actual outcome of a bilateral negotiation depend on the relative bargaining power of the two MNOs. The presence of traffic imbalances creates incentives for the MNO with the surplus of incoming calls to raise termination charges above cost and for the MNO with a deficit to reduce them. This tension between the operator in surplus and the operator in deficit together with the veto power each of them would have could create a degree of 'stickiness' in the movement of voice call termination charges from any starting position. Hence, the Director concluded that, since negotiations would begin at the current (high) level of termination charges, it is likely that the existing traffic imbalances would not lead to a reduction in off-net termination charges.

5.69 In addition, the Director made the point that the current literature does not consider the implication that the entry of a new player in the market would have on

the incentives of the incumbents. He argued that the four MNOs may find it mutually beneficial to keep off-net termination charges high to create an entry barrier for the new entrant^[25] and, therefore, that the bilateral negotiations may not be effective in bringing termination charges down to cost level.

5.70 Hence, the Director dismissed Vodafone's suggested remedy on the basis that the current economic literature is insufficiently robust to conclude that no direct regulation of off-net termination charges is required. He maintained that a charge control for off-net termination charges was still the most effective remedy available to bring the charges down to cost. However, he made the point that the presence of the control did not prevent the MNOs to engage in bilateral negotiations and that, if Vodafone's argument was correct, the cap on off-net termination charges would not bind.

Bilateral agreements: MNOs' comments

5.71 In its response to the May consultation, Vodafone has again put forward the claim that bilateral agreements are an effective alternative to a charge control for constraining off-net termination charges. Vodafone has made a number of specific comments, which are discussed below together with the Director's responses.

Bilateral agreements: Robustness of the economic literature

5.72 Vodafone argues that the effectiveness of its proposed remedy is supported by the existing economic literature on the subject which is "virtually all" in support of the view that bilateral agreements will not lead to excessive termination charges. It further claims that "this conclusion applies regardless of the particular models used and is not dependent on the use of a model which assumes particular market conditions".

5.73 Furthermore, Vodafone dismisses Armstrong's model²⁶ put forward by the Director as an example of a model where bilateral agreements lead to above costs mobile to mobile termination charges on the basis that it is based on some specific and unrealistic assumptions.

5.74 The Director does not agree with Vodafone's claims. The literature on which Vodafone relies is, as repeatedly pointed out, still developing and the limited number of models it comprises are stylized and simplistic. Dr Armstrong, who is one of the contributors to this literature, agrees with the Director that it would be unsafe to base a regulatory decision on it.

5.75 In addition, the Director considers that the models that support Vodafone's proposal yield their result under restrictive assumptions which are unlikely to be satisfied (e.g. the assumption that traffic flows are balanced across all pairs of MNOs). If some of these assumptions are relaxed, the Director does not consider that the same conclusion would be reached (e.g. the presence of traffic imbalances may make render the charges sticky downwards).

²⁵ The Director's views are discussed in more detail in the Oftel papers: *Termination of off-net mobile to mobile calls* and *Bilateral Agreement of Mobile-to-mobile Call Termination Charges*.

²⁶ The paper "Call termination on mobile networks" (April 2002) by Dr. Armstrong.

5.76 The Director considers that incentives of the MNOs are not aligned with the interest of consumers and that, when engaged in bilateral negotiations, the MNOs will be seeking to set termination charges that maximize their joint profits. This objective can also be advanced by setting termination charges in a way that weakens retail competition.

5.77 Further, the Director points out that the MNOs may strategically use termination charges to create a barrier to entry for new entrants and that this incentive is overlooked in the literature on which Vodafone relies.

Bilateral agreements: Traffic imbalances

5.78 Vodafone dismisses the Director's concern about the effect of traffic imbalances between MNOs on the outcomes of the bilateral agreements. It claims that "as long as termination charges are above the marginal cost of termination, which will be the case in the presence of fixed and common costs, then MNOs will each have an incentive to generate an interconnection traffic surplus" and, thus, over time traffic can be expected to be in balance. Vodafone thus concludes that MNOs will anticipate that any traffic imbalance they may be facing at a particular point in time is unlikely to persist and this will eliminate any downwards stickiness of termination charges. In addition, Vodafone holds that the Director can always intervene if two MNOs cannot agree on a termination charge at the request of the dissatisfied MNO under its power to resolve disputes.

5.79 The Director considers that any proposed remedy should be robust whether there are traffic imbalances or not. Termination charges have been well above cost for the last few years, but this has not led to a balance in traffic flows, hence, there is no reason to expect that this should happen in the future. Consumer heterogeneity and differing commercial strategies render the persistence of traffic imbalances likely. These imbalances might prevent agreements to be reached in bilateral negotiations where each MNO has veto power against change, as the MNO with a surplus of traffic in its favour will have no incentive to reduce the termination charge. As mentioned above, the likelihood of this outcome is increased by the fact that MNOs would be starting from the current high level of termination charges. Therefore, relying on a remedy that requires balance traffic to be effective does not appear to the Director as a robust regulatory intervention.

5.80 Vodafone's suggestion of relying on dispute resolution procedures to provide for the deficiencies of this remedy does not allay the Director's concern about the ineffectiveness of the remedy. Given the likelihood that traffic flows will not be balanced, this suggestion could require frequent and lengthy ex-post interventions which may be as intrusive as a charge control as the Director may be forced to set the termination charge. Annex N discuss further reasons why the Director believes that in the termination market the SMP of the MNOs is better addressed by an ex-ante than by an ex-post regulatory intervention. The Director is proposing to set a cap on off-net termination charges, which provides a safeguard for customers, but he is not preventing MNOs from entering into bilateral agreements. If Vodafone's argument is correct, this cap will simply not be binding.

Bilateral agreements: New entrants

5.81 Vodafone disagrees with the Director's view that bilateral agreements do not work effectively when there are new entrants in the mobile market (because MNOs would have the incentive to set high termination charges to these new operators to reduce their ability to compete). Vodafone argues that this incentive can be controlled for by requiring each established MNO to offer the entrant a termination charge no higher than the average charge it offers to the other established MNOs, until this MNO is able to build sufficient market share to be able to negotiate termination on equal terms.

5.82 The Director considers that this solution does not address his concern. Even if all MNOs, the incumbents and the new entrant alike, faced the same high termination charge, this would disproportionately affect the new entrant, given that a much larger share of its mobile-to-mobile traffic will be off-net. Hence, Vodafone's proposal does not eliminate the incentives on the established MNOs to agree to keep all termination charges high so as to impair the new entrant's ability to compete in the retail mobile market.

Voluntary bilateral agreements

5.83 Vodafone concludes by arguing that the Director's current charge control proposal will render it practically impossible for MNOs to move towards a voluntary bilateral agreements solution. It provides the following reasons for this claim:

- a) the Director is proposing too low a target charge for fixed-to-mobiles termination charges;
- b) MNOs are unwilling to agree a lower termination charge to apply inter se, as they are concerned that they might expect that this charge could be used by the Director as a benchmark for the fixed-to-mobile charge;
- c) the non-discrimination obligation proposed by the Director limits the flexibility of the bilateral agreements an MNO can stipulate with each other MNO; and
- d) the Director has not provided that any interconnection agreement between any two MNOs should only govern the termination charges to apply to all traffic originating from one MNO's subscribers and terminating on the other MNO's network.

5.84 The Director does not consider that his current charge control proposals prevent the MNOs from entering into voluntary bilateral agreements.

5.85 With regard to a), the Director considers that the cap he is proposing for fixed-to-mobile termination charges is set at the appropriate level.

5.86 With regard to b), the Director cannot pre-commit to ignore potentially relevant information.

5.87 With regard to c), the non-discriminatory obligation the Director is proposing only requires MNOs to refrain from any form of undue discrimination. Discriminatory

behaviour would therefore not be considered in breach of the proposed obligation if objectively justified. However, the Director cannot pre-judge issues that could potentially arise about anti-competitive behaviour.

5.88 With regard to d), Vodafone considers that the Director should prohibit arbitrage of termination of calls through the cheaper route. The Director's view is that this is a contractual matter the MNOs should deal with as part of their negotiations and that Vodafone's proposal would result in over-regulation.

5.89 The Director remains therefore of the view that his proposal does not prevent the MNOs from entering into bilateral agreements for setting off-net termination charges which avoid anti-competitive effects. If the argument put forward by Vodafone is correct, then the safeguard cap on off-net charges would be a non-binding constraint. If the argument proves incorrect, the cap would provide protection against the incentives MNOs have to set excessive off-net termination charges.

Conclusion on bilateral agreements

5.90 In conclusion, the Director is still of the view that bilateral negotiations cannot be relied upon to keep mobile to mobile termination charges at the competitive level. He considers that the analysis that underlies Vodafone's proposal is incomplete and not robust. The relevant economic theory is a developing literature of a small number of simplified and stylised models. He believes that the MNOs' incentives are not aligned with the interests of consumers, as they have incentives to set termination charges for mobile to mobile calls so as to maximise their joint profits and this may lead to non-competitive outcomes. In addition, traffic imbalances are likely to make termination charges sticky downwards, because the MNO with the balance of inbound traffic would prefer the status quo of high termination charges. Furthermore, MNOs may find it mutually beneficial to keep off-net termination charges high to create an entry barrier to be faced by the new entrant '3'. The Director is still of the view that a safeguard charge cap on off-net termination charges is necessary, but it remains open to the MNOs to voluntarily engage in bilateral negotiations.

5.91 The Director notes that his view that bilateral negotiations would not avoid the need to regulate mobile-to-mobile voice termination charges is supported by the CC (see paragraph 2.479 of the CC Report).

Pass-through

5.92 Orange, T-Mobile and Vodafone all raised the issue of fixed operators passing on the price reductions generated by a charge control. It was suggested that if a charge control is imposed on MNOs, it should be supported by pass-through regulation applied to BT.

5.93 The Director notes the concerns regarding BT's pass-through of reductions in mobile termination charges into lower retail prices for fixed to mobile calls. This issue has been considered in the relevant market review. The regulation of BT's prices will require it to pass on the cuts overall in its retail prices. This is because the basket of BT's services subject to a price cap includes the 'retention', i.e. the

difference between BT's retail price for fixed to mobile calls and the mobile termination charge. Furthermore, Annex G of the Fixed Narrowband Retail Services market review (26 August 2003) advises of the Director's view that:

Following a reduction in mobile termination charges, if BT were to do nothing in price control terms by leaving its retention at the same level, a reduction in the termination charge would result in an equivalent reduction in the fixed-to-mobile price (since the retail price is the retention plus the termination charge).

The Director will be monitoring this closely. If BT were to fail to pass on the great majority of termination charge reductions, the Director would be prepared to investigate and take appropriate regulatory action, to ensure that the benefits of lower termination charges were indeed passed through.

Proposed charge controls and EU Directives

5.94 It was also argued that the proposed charge controls were not justified under EU Directives. As discussed in paragraphs 5.6 and 5.7, the Director has considered the option of no ex ante regulation, all of the requirements of Article 8 of the Framework Directive, as well as the requirement to encourage network access and service interoperability for the purposes, inter alia, of securing efficient and sustainable competition in the markets for electronic communications networks and services, and for securing maximum benefits of customers of communications providers. Further, as explained in paragraph 5.8, the Director has ensured that as well as being appropriate (section 87(1)), the charge control conditions proposed satisfy the tests set out in section 47 and 87(4) of the Act, and additional requirements for network access pricing conditions, set out in section 88 of the Act.

Conclusion on charge controls

5.95 In Chapter 3, the Director sets out his view that each MNO has a monopoly of voice call termination on its own network(s) and that the Director considers that MNOs are likely to continue to have SMP for at least the next three years.

5.96 As further discussed in Chapter 3 and Annex D, it appears to the Director that there are insufficient constraints on the four MNOs' ability to raise termination charges above the competitive level. In the absence of regulation, the four MNOs would have the incentive to set a profit-maximizing price for the provision of wholesale voice call termination. The detriments of this are discussed in greater detail in Chapter 4.

5.97 The Director remains of the view that a charge control may be appropriate on the four MNOs' 2G termination services, given the risk that excessive prices will be set due to a lack of competition in the market. To deal with this a charge control with transparent, easy to monitor compliance conditions can help to ensure that firms do not abuse their dominant position and that competition develops to the benefit of consumers.

5.98 Charge controls in respect of 3G voice call termination services may be considered disproportionate. 3G retail services are new and innovative and as such are only taken by a relatively small number of subscribers at the moment, although this may be expected to change over the period of this review. As stated elsewhere in this document regulation of such services is likely to have an adverse impact on continued investment in to new 3G services, which may limit consumer choice in the longer term. The Director currently therefore still considers that it would be disproportionate to make termination on 3G networks subject to charge controls.

5.99 The two main forms of charge regulation are an RPI-X control and a rate of return control. Under the former, the firm is prevented from increasing prices by more than inflation minus X percent per annum. Under the latter arrangement, the firm is required to earn no more than the specified rate of return in each year. This is a form of cost plus regulation and requires the level of allowable costs to be assessed annually.

5.100 RPI-X regulation has a number of advantages over rate of return control. In particular, it avoids overly intrusive and bureaucratic regulation. Price controls are not set every year according to the rate of return earned in the year, but for a period of years, and they are not revisited until the end of the period.

5.101 By contrast, rate of return control is burdensome, requiring detailed assessments of costs on an annual basis.

5.102 In the Director's view, a charge control if appropriately designed is a proportionate response where competitive pressures and other regulation is not otherwise sufficient to ensure that prices are cost reflective. In this case, the charge control would address SMP and the lack of competitive pressures to constrain charges to the competitive level and the material adverse effects this would have on end-users.

5.103 For the reasons discussed, the Director's initial view is that only the four MNOs' charges for 2G voice call termination services should be subject to a form of RPI-X charge control. Details of this control are discussed in Chapter 6.

5.104 In the case of '3', the Director does not consider that such a control of the charges set by '3' for 2G termination services is appropriate at this time. As discussed below, where it cannot offer voice call termination using its own 3G radio layer, '3' uses another MNO's 2G radio layer in order to offer voice call termination services. The Director is currently of the view that there is insufficient evidence to suggest that '3' would set charges for such 2G voice call termination at levels significantly above the established industry levels (by adding an excessive margin on top of costs). Further, that '3' has strong incentives to use its own 3G network for the termination of voice calls (rather than another MNO's 2G radio network, when terminating voice calls).

5.105 '3's asymmetric position in the retail market as compared to the four MNOs (as discussed in Chapter 4), combined with its smaller customer base, its position as a new entrant and its use of 2G voice call termination services, would suggest that a

charge control of its 2G voice call termination services is inappropriate and disproportionate at this time.

5.106 In relation to Inquam, as it has a very small customer base and the vast majority of the calls terminating on its network are on-net, it therefore provides voice call termination to operators other than itself on very limited occasions. The Director therefore considers that a charge control obligation would be inappropriate and disproportionate at this time.

Cost accounting and accounting separation

5.107 Energis and SPC Network both proposed that accounting separation should be applied to the operators for their 2G services, on the basis that the Director would impose a non-discrimination obligation to avoid vertical discrimination.

5.108 As set out in the May consultation, accounting obligations are used to monitor compliance with other regulatory obligations such as an obligation to set charges on a forward looking long run incremental basis. The Director's view at that time was that, in the absence of any proposals for such regulatory obligations (instead, a control with a specific target charge is proposed), there was no explicit need for such accounting obligations. This position currently remains unchanged.

Treatment of 3G

5.109 In the May consultation, the Director proposed no ex ante regulation in respect of 3G voice call termination services.

5.110 The Fixed Alternative Networks, Energis, '3' and Vodafone expressed their agreement with the Director's proposals, although Energis noted that this should be reviewed over time as 3G rolled out. BT disagreed and considered that either averaging 2G and 3G charges, post billing adjustments (billing separately for 2G and 3G) or a different number range for 3G calls should be introduced. BT's view was based on its assertion that the market for voice call termination should cover both 2G and 3G networks. Orange also disagreed with the Director's proposal and, although opposed to the charge control, considered that if a charge control is applied to 2G operators it should also be applied to voice call termination by '3' on its 3G network.

5.111 Whilst the Director's considers 2G and 3G call termination to be in the same market, his view remains that ex ante regulation is not appropriate for calls terminated on 3G networks, as 3G services are new and innovative, take-up is uncertain and costs are still difficult to assess. In general, and consistent with what has been stated in the past, the Director does not normally apply regulatory controls to such new and developing services as regulation could deter continued investment and the development of new services, ultimately disadvantaging consumers.

5.112 Therefore, the Director does not currently consider it appropriate to apply the same remedies for 3G as he is proposing for 2G voice call termination.

5.113 However, whilst at present ex ante regulation is not appropriate for voice call termination services on 3G networks, the Director agrees with Energis that this position will need to be kept under review.

Treatment of Inquam

5.114 Vodafone and Energis generally agreed with the Director's proposals for Inquam. BT, '3' and Orange stated that Inquam should be subject to the same treatment as '3', while O2 believed that Inquam should be subject to the same obligations as the other 2G operators. Energis did, however, raise an argument that Inquam should be subject to a non-discrimination obligation and this was discussed earlier in this document (see paragraph 5.41)

5.115 The Director does not agree with O2's view that Inquam should be subject to the same obligations as O2, Orange, T-Mobile and Vodafone. Nor does the Director agree that Inquam should be treated in the same way as '3'.

5.116 As discussed in Chapter 3, Inquam holds a unique position amongst the six MNOs in that it exclusively serves closed user groups who rarely make calls outside these groups. The result is that the majority of calls to its subscribers are on-net (note that it is the result of the closed user groups and not the size of the customer base that creates this effect - a key difference between Inquam and '3'). The customer base itself is also very small relative to those of the other MNOs (based on the figures Oftel quoted in the May consultation, Inquam has only 0.1% of the total number of UK subscribers). Ex ante regulation should reflect this position and, whilst the Director's current view is that Inquam holds a position of SMP within the market for terminating voice calls on its network, Inquam is very unlikely to use this to generate the detrimental effects discussed in Chapter 4.

5.117 However, the Director is also of the view that by holding a position of SMP, some risk of detrimental effects, however small, remains. There is also the prospect that in the future Inquam's customer base could grow or change. Some monitoring of Inquam's performance and behaviour is therefore justified and, whilst performance can be measured by market indicators such as customer base, the Director also considers a transparency obligation appropriate in order to assist with the monitoring of Inquam's behaviour.

Treatment of '3's 2G voice termination services

5.118 In the May consultation, the Director proposed that '3' should be subject to ex ante regulation. The Director's view at that time was that a requirement on '3' to set charges for 2G voice call termination services on the basis of forward looking long-run incremental costs ("LRIC") would be proportionate.

5.119 In their responses, both BT and the NCC were in favour of the Director's proposals. Both also argued that the proposed obligation should also be applied to the termination of all 3G calls. As discussed in paragraphs 5.105 to 5.109 above, the Director does not currently consider it appropriate to apply ex ante conditions to 3G voice call termination.

5.120 In its response, O2 agreed in principle with the Director's proposals, but raised a concern that the Director had not published details of how '3's LRIC would be assessed and the effect of the Director's proposal would not be clear.

5.121 Like O2, '3' also raised concerns about the lack of detail contained within the Director's proposals. '3' argued that the proposals did not contain information on '3' and instead described proposals in respect of "the incumbents". In particular, '3' was concerned that the Director's proposals did not specify the manner in which an appropriate rate of return on capital and an appropriate mark-up for the recovery of common costs would be calculated.

5.122 '3' also explained that any calculation of its costs has to take account of its unique position. '3' suggested that the cost of capital calculations used for other MNOs would be inappropriate, as the Director's proposals for cost of capital calculations assume costs for a reasonably efficient 2G mobile operator in the UK, whilst '3' does not provide 2G termination as a stand-alone service.

5.123 In addition, '3' advised the Director of its view that a LRIC based obligation would be inappropriate, as '3' was still building out its network and demand for its services is as yet uncertain. '3' felt that the proposal would reduce its ability to compete and would therefore affect retail competition in the longer term.

5.124 The Director has considered whether his proposal is appropriate and proportionate. Since the May consultation, the Director has been advised that '3' offers a 2G voice call termination service by switching calls at the gateway MSC²⁷ and thereafter using the 2G radio network of O2 as part of a roaming agreement. The Director has also taken account of '3's position as a new entrant, its incentive and ability to set excessive charges and any evidence of '3's pricing strategy since the launch of its services. The Director has also considered the concerns raised regarding the calculation of a LRIC based charge obligation and with this in mind, how such an obligation would be enforced.

5.125 The Director is still of the view that '3' has the ability to set excessive charges for 2G termination services. As with all MNOs, '3' is the only MNO that can terminate calls to its subscribers, hence it has the freedom to set charges above the competitive level.

5.126 Costs incurred by '3' when terminating 2G calls include a payment to O2 as part of a roaming agreement. This might suggest that charges set by '3' for 2G termination would be above the industry norm. The Director's concern, however, is whether '3' uses its ability to set excessive charges for voice call termination (i.e. charges well above those costs incurred).

5.127 In its response, '3' argued that as a new entrant it has an incentive to implement interconnection quickly, whereas those interconnecting with it do not. '3'

²⁷ MSC = Mobile services switching centre. The MSC co-ordinates the setting up of calls to and from mobile phones in the GSM operator's network

believes that it is this imbalance that leads to negotiated termination charges not reaching excessive levels.

5.128 The Director recognises that, whilst it has the ability, whether '3' has the incentive to set excessive charges for 2G voice call termination service is less certain. The Director accepts that so far, '3' has set charges for 2G voice call termination services in line with those of the other MNOs. This does not mean however that charges will remain so indefinitely, or that '3' lacks the ability to significantly raise the level of charges for 2G termination services.

5.129 The Director also notes however that '3' is unique in that its own network is exclusively 3G and '3' only offers 2G voice call termination for locations where using its own 3G network alone it is unable to complete the termination of a voice call. In such circumstances, calls to '3's subscribers are first carried over '3's 3G core network and are then passed onto O2's radio network to complete the termination. Whilst it is obviously of key importance that 3G network coverage is available to allow '3' to deliver innovative data services to its subscribers, for reasons of efficiency, it is also in '3's interest to use its own network for the termination of voice calls. This would suggest that the proportion of calls terminated by '3' that use 2G termination services will drop over time.

5.130 In addition to uncertainty regarding '3's incentive to set excessive charges, combined with '3's unique position as an MNO, the Director also notes that in order to verify that charges are LRIC based, the Director would first require a detailed examination of '3's costs, in particular cost of capital. This examination would consider costs concerning a service that is still in the early stages roll-out. It would also need to reflect an anticipated drop in the percentage of calls terminated using a 2G service. If regulated charges are based on cost information that is changing significantly over time, revisions to the obligation may be needed to ensure that there is no over or under recovery.

5.131 The Director therefore now considers that a LRIC-based obligation for 2G voice call termination by '3' may not be justified, given the difficulties in assessing the costs involved in using a new and innovative 3G service, and which is likely to require regular updating as '3' aims to minimise the very service the control is intended to address.

5.132 The Director has therefore concluded that a LRIC-based obligation is not proportionate because:

- a) so far, there is insufficient evidence to suggest that '3' will set charges for 2G voice call termination at levels significantly above the established industry levels (by adding an excessive margin on top of costs);
 - b) '3' has strong incentives to use its own 3G network, and not another MNO's 2G radio network, when terminating voice calls; and
 - c) enforcing a LRIC obligation would place a significant burden on '3' to provide accurate and updated information.
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5.133 However, '3' still retains the ability to raise 2G voice call termination charges. The Director's view that a LRIC based obligation would be inappropriate is based on assumptions that over time:

- i) the percentage of voice calls terminated by '3' on a 2G network will reduce; and
- ii) charges for 2G voice call termination will not increase to excessive levels, but instead will stay in line with those of industry.

5.134 However, addressing the fact that '3' is able to raise charges for 2G voice call termination, the Director takes the view that a reporting obligation is required to offer transparency of '3's behaviour.

5.135 The Director believes that such an obligation should take the form of a requirement to provide advance notification of changes to charges for 2G voice call termination to interested parties, and periodic notification of call volumes to the Director. This would allow PECN providers to adapt to changes to termination charges of '3', and the Director to monitor '3's behaviour and assess whether his assumptions, and therefore his proposals for regulation, are appropriate.

5.136 The Director considers the obligation to be proportionate in that it is the least onerous obligation required in order to ensure the requisite transparency required by PECNs and the Director. It is a straight-forward task to publish changes to charges for 2G voice call termination, and as '3' has to pay a roaming fee to O2 for 2G calls, it must know retrospectively the volume of calls terminated as 2G. The proposed obligation is justified as it addresses '3's ability to raise charges for voice call termination.

5.137 The Director takes the view that the periodic notification of call volumes should be quarterly, as this allows regular review but an appropriate period between reports to allow '3' to collate sufficient data for analysis.

Draft Decision

O2, Orange, T-Mobile and Vodafone

▪ *Requirement to provide network access (proposed condition MC1 and MD1)*

5.138 As discussed in paragraph 5.30, O2, Orange, T-Mobile and Vodafone (‘the four MNOs’) have the ability and may have, or could develop, the incentive not to offer access on fair and reasonable terms. The absence of an obligation on the four MNOs to provide mobile voice call termination services on fair and reasonable terms could severely impede competition in downstream markets, for example, by restricting the ability of other PECN providers to use such services by means of setting unfair terms and conditions, whilst the inclusion of an access obligation is in no way onerous for MNOs, yet provides regulatory certainty for other PECN providers.

5.139 For these reasons, the Director believes that these MNOs should be required to meet all reasonable requests to provide wholesale mobile voice call termination services on their network(s) and should be required to do so on reasonable terms.

5.140 Section 87(3) of the Act authorises the setting of SMP services conditions requiring the dominant provider to provide network access, as the Director may from time to time direct. These conditions may, pursuant to section 87(5), include provision for securing fairness and reasonableness in the way in which requests for network access are made and responded to and for securing that the obligations in the conditions are complied with within periods and at times required by or under the conditions. When considering the imposition of such conditions in a particular case, the Director must have regard to the 6 factors set out in section 87(4) of the Act, including, inter alia, the technical and economic viability of installing other competing facilities and the feasibility of the proposed network access.

5.141 Further guidance as to how the Director proposes to apply the network access obligation can be found in the Director’s guidelines on imposing access obligations under the new EU Directives, dated 13 September 2002 (the “Access Guidelines”) and the Director’s guidelines for the interconnection of public electronic communications networks, dated 23 May 2003 (the “Interconnection Guidelines”). These guidelines can be found at www.oftel.gov.uk/publications/ind_guidelines/acce0902.htm and www.oftel.gov.uk/publications/eu_directives/2003/intercon0503.htm respectively.

5.142 Having considered the May consultation responses, the Director believes that it is appropriate to impose a network access condition in this market (limited to 2G termination services only). The proposed conditions MC1 and MD1 are set out in the Notification at Annex C.

5.143 The Director, in proposing this obligation has considered all the Community requirements set out in section 4 of the Act, in particular the requirements to promote competition, secure efficient and sustainable competition and secure the maximum benefit for retail consumers. Furthermore, the Director has considered his general duties under section 3 of the Act, in particular the requirements to further the

interests of citizens and to promote competition. In particular, an access obligation ensures that other PECN providers are able to complete calls to subscribers of the MNOs in question under fair and reasonable terms. By ensuring that competing PECN providers are therefore not disadvantaged through the application of unfair or unreasonable terms, the requirement promotes competition, ultimately furthers the interests of consumers and citizens, and helps to secure effective and sustainable competition.

5.144 The Director believes that these conditions meet the tests set out in section 47 of the Act. Section 47 requires conditions to be justifiable, non-discriminatory, proportionate and transparent. The proposed conditions are objectively justifiable, in that they are aimed at ensuring that 2G call termination services are provided by the four MNOs, such that competition develops to the benefit of consumers (see paragraph 5.143 above). They do not discriminate unduly, in that they apply equally to all those MNOs who, in the view of the Director, have the ability and have, or could, develop the incentive not to offer access on fair and reasonable terms. They are proportionate, since they do not require MNOs to provide access if the request is unreasonable, and only require access to be provided to public electronic communications network providers. Additionally, they are transparent, in that the proposed conditions have been drafted to secure maximum transparency, which is aided by the explanation as to the intended operation and effect of the conditions as set out in this document.

5.145 The Director in making this proposal has taken into account all the factors listed in section 87(4) of the Act, in particular the feasibility of the provision of the proposed network access and the need to secure effective competition in the long term – the Director believes it is feasible for the four MNOs to provide such network access and that the proposal will help to secure effective competition in the long term (see paragraph 5.143 above)

- ***Obligation not to unduly discriminate in the provision of such access (proposed Condition MC2 and MD2)***

5.146 As discussed in paragraph 5.33, the Director considers that the four MNOs have the ability and the incentive to discriminate in the provision of network access in a manner that unfairly disadvantages another PECN provider. In the absence of an obligation to not unduly discriminate in the provision of network access, this ability and incentive is not addressed.

5.147 For these reasons, the Director believes that these MNOs should be prevented from unduly discriminating in the provision of wholesale mobile voice call termination services on their networks.

5.148 Section 87(6)(a) of the Act authorises the setting of an SMP services condition requiring the dominant provider not to unduly discriminate against particular persons, or against a particular description of persons, in relation to matters connected with the provision of network access.

5.149 As discussed in paragraph 5.37, the requirement not to unduly discriminate is intended, principally, to prevent MNOs from discriminating horizontally against other PECN providers, but this does not exclude other forms of discrimination.

5.150 For example, as MNOs are vertically integrated, they may also have an incentive to provide wholesale services on terms and conditions that favour their own retail activities and in a way that could have a material adverse effect on competition. In particular, MNOs may charge competing providers more than the amount charged (through transfer charging) to their own retail arms for wholesale voice call termination services, thereby increasing the costs of competing providers and giving itself an unfair competitive advantage. Such behaviour would be covered by the proposed condition.

5.151 A prohibition to discriminate might have disadvantages, if it prevented discrimination that was economically efficient or justified. This is why the proposed condition provides that there should be no *undue* discrimination. Ofcom has considered how it might treat undue discrimination in its Access Guidelines. In paragraph 3.8 of these Guidelines it is stated:

“3.8 ‘Non-discrimination’ does not necessarily mean that there should be no differences in treatment between undertakings, rather that any differences should be objectively justifiable, for example by:

- a) differences in underlying costs, or
- b) no material adverse effect of competition.”

The Access Guidelines also state that, in the Director’s view, there is a rebuttable presumption that a vertically integrated SMP provider discriminating in favour of its own retail activities or between other PECN providers would have a material adverse effect on competition (see paragraph 3.9).

5.152 The Director, in proposing this obligation has considered all the Community requirements set out in section 4 of the Act, in particular the requirements to promote competition, secure efficient and sustainable competition and secure the maximum benefit for retail consumers. Furthermore, the Director has considered his general duties under section 3 of the Act, in particular the requirements to further the interests of citizens and to promote competition. In particular, an obligation to not unduly discriminate ensures that other PECN providers are not unfairly disadvantaged in the provision of access to 2G voice call termination services by the MNOs in question. By ensuring that competing PECN providers are not discriminated against so as to materially affect their ability to compete, the requirement therefore promotes competition, furthers the interests of consumers and citizens, and helps to secure effective and sustainable competition.

5.153 The Director believes that these conditions meet the tests set out in section 47 of the Act. Section 47 requires conditions to be justifiable, non-discriminatory, proportionate and transparent. The Director believes that these proposed conditions are objectively justifiable, in that they provides safeguards to ensure that competing PECN providers, and hence consumers (who would gain the benefits of competition), are not disadvantaged by an MNO unduly discriminating between them. They do not discriminate unduly against any MNO, in that they apply equally to

all those MNOs who, in the view of the Director, have the ability and incentive to unduly discriminate. They are proportionate in that discrimination is only prohibited if it is 'undue' and are the least onerous obligations required to address the concerns outlined above. In addition, the proposed conditions are transparent, in that they have been drafted so as to secure maximum transparency, which is aided by the explanation as to the intended operation and effect of the conditions as set out in this document.

- ***Control of charges for 2G voice fixed-to-mobile and mobile-to-mobile termination services (proposed Condition MC3 and MD3)***

5.154 As discussed in paragraph 5.96 to 5.97, the Director considers that the four MNOs have the ability and the incentive to set a profit-maximizing price for the provision of wholesale voice call termination services to another PECN provider. In the absence of a charge control on the four MNOs' 2G termination services, the risk that excessive prices will be set due to a lack of competition in the market is not addressed.

5.155 For these reasons, the Director believes that the four MNOs should be subject to a charge control for the provision of wholesale 2G mobile voice call termination services on their networks.

5.156 Section 87(9)(a) of the Act authorises the setting of an SMP services condition imposing charge controls in relation to matter connected with the provision of network access.

5.157 Section 88(1) of the Act authorises the setting of an SMP condition falling within section 87(9) where there is a relevant risk of adverse effects arising from price distortion; and it also appears that the setting of the condition is appropriate for the purposes of promoting efficiency, promoting sustainable competition and conferring the greatest possible benefits on the end-users of public electronic communications services.

5.158 As discussed in paragraph 5.98 the obligation to set charges for 2G voice call termination services in line with charge controls is intended, principally, to prevent MNOs from setting excessive charges. This is to protect other PECN providers purchasing those services from anti-competitive behaviour and to further the interest of consumers.

5.159 Such anti-competitive behaviour might include anti-competitive price discrimination against '3' or other new entrants (see paragraphs 4.52 to 4.55). Benefits to consumers are as discussed throughout Chapter 4 and in Annex L (Cost Benefit Analysis), and include efficiency gains, distributional effects and effects on consumer choice.

5.160 The Director, in proposing this obligation has considered all the Community requirements set out in section 4 of the Act, in particular the requirements to promote competition, secure efficient and sustainable competition and secure the maximum benefit for retail consumers. Furthermore, the Director has considered his general duties under section 3 of the Act, in particular the requirements to further the

interests of citizens and consumers to promote competition. The Director has performed those duties also by ensuring that, for the purposes of imposing a charge control, the tests set out in section 88(1) of the Act have been met. As discussed above in Chapter 4, it appears from the market analysis that there is a relevant risk of adverse effects arising from price distortion. In particular, the Director considers that there is relevant risk of adverse effects arising from price distortion as the four MNOs might so fix or maintain some or all of their prices at an excessively high level as to have adverse consequences for end-users of mobile call termination services. The proposed charge control is also designed to reflect considerations of economic efficiency and have the intention to maximise benefits to end-users. As required by section 88(1)(b) of the Act, this obligation therefore promotes efficiency, confers the greatest possible benefits on the end-users and, by ensuring that PECN Providers competing for customers in the retail market are not exploited by the four MNOs setting excessive prices in the wholesale market, promotes effective and sustainable competition. The charge control proposed also ensures that other PECN providers (such as '3') are not unfairly disadvantaged in the provision of access to 2G voice call termination services by the MNOs in question. Furthermore, as set out in Annex F, the proposed charge control has taken account of the costs and reasonable rates of return on investments required by the four MNOs in providing wholesale 2G voice call termination. As such, the proposed charge control takes account of the extent of the investment in the matters to which the condition relates of the four MNOs, as required by section 88(2) of the Act

5.161 The Director believes that these conditions meet the tests set out in section 47 of the Act. Section 47 requires conditions to be justifiable, non-discriminatory, proportionate and transparent. The Director believes that these proposed conditions are objectively justifiable, in that they provide safeguards to ensure that competing PECN providers and consumers are not disadvantaged by an MNO setting excessive charges for wholesale 2G voice call termination services. They do not discriminate unduly against any MNO, in that they apply equally to all four MNOs who, in the view of the Director, have the ability and incentive to set excessive charges for wholesale 2G voice call termination services. As set out in Chapter 6 and Annex H, they are proportionate in that the charge control is the least onerous obligation, in the Director's view, to address effectively the concerns set out above, as in the absence of such a control there is a serious risk of adverse effects arising from excessive termination charges (discussed in Chapter 4). Furthermore, the charge control is designed to reflect considerations of economic efficiency and has the intention to maximise benefits to end-users. Additionally, the proposed conditions are transparent, in that they have been drafted so as to secure maximum transparency, which is aided by the explanation as to the intended operation and effect of the conditions as set out in this document.

- ***Obligation to supply Access Contracts (proposed Condition MC5 and MD5)***

5.162 A requirement on communications providers with SMP to supply interconnect agreements to the Director, would have the main purpose of assisting transparency for the monitoring of potential anti-competitive behaviour. Such an obligation would

help to ensure stability in the relevant markets and help to maintain incentives to invest that might otherwise be undermined and thus discourage market entry.

5.163 The provision of such an obligation would give confidence to those purchasing wholesale access services that those services were being provided on non-discriminatory terms. In the absence of such an obligation, market entry might be deterred to the detriment of the long-term development of competition and of consumers. This obligation is particularly important in the markets for the provision of wholesale mobile voice call termination services, as all PECN providers (MNOs and FNOs) – either directly or indirectly – have to buy call termination services in order to complete calls.

5.164 For these reasons, the Director believes that it is necessary to require MNOs to provide to the Director copies of all new or amended interconnect agreements for wholesale mobile voice call termination services (limited to 2G services only).

5.165 Section 87(6)(b) of the Act authorises the setting of SMP services conditions which require a dominant provider to publish, in such manner as the Director may direct, all such information for the purpose of securing transparency. Section 87(6)(c) of the Act authorises the setting of SMP services conditions which require a dominant provider to publish, in such manner as the Director may from time to time direct, the terms and conditions on which he is willing to enter into an access contract. Section 87(6)(d) also permits the setting of conditions requiring the terms and conditions on which the dominant provider is willing to enter into an access contract to include such terms and conditions as may be specified or described in the condition. Section 87(6)(e) allows a condition requiring the dominant provider to make such modifications as the Director may direct of any offer by that provider which sets out the terms and conditions on which he is willing to enter into an access contract.

5.166 As authorised by the above provisions the proposed SMP conditions in the Notification at Annex C would require MNOs provide details of new or amended Access Contracts.

5.167 In light of comments from MNOs, the text of the proposed condition has been amended from the Reference Offer obligation contained in the May consultation document. The Director accepts that the RO obligations previously proposed could be interpreted as being wider than the specific agreements made by MNOs for wholesale voice call termination services, and are therefore unnecessary and disproportionate.

5.168 Having considered the May consultation responses, the Director believes that he should impose a condition on the four MNOs under which they would be required to provide him with copies of all new or amended interconnect agreements, in the relevant markets (but limited to 2G services only). The form of proposed conditions MC5 and MD5 are set out in the Notification at Annex C.

5.169 The Director, in proposing this obligation has considered all the Community requirements set out in section 4 of the Act, in particular the requirements to promote competition, secure efficient and sustainable competition and secure the maximum

benefit for retail consumers. Furthermore, the Director has considered his general duties under section 3 of the Act, in particular the requirements to further the interests of citizens and to promote competition. In particular, this transparency provides certainty to PECN providers and complements other obligations such as the obligation to not unduly discriminate, without risking commercial confidentiality or network security. The requirement therefore promotes competition, furthers the interests of consumers and citizens, and helps to secure effective and sustainable competition.

5.170 The Director believes that these conditions meet the tests set out in section 47 of the Act. Section 47 requires conditions to be justifiable, non-discriminatory, proportionate and transparent. The proposed conditions are objectively justifiable, in that they ensure that the terms and conditions are published which will encourage competition and provide stability in the relevant markets. They do not unduly discriminate in that they apply equally to all MNOs who have the ability and incentive to discriminate and in circumstances where the Director is required to monitor other obligations, such as no undue discrimination and a charge control. They are proportionate as they are the least onerous obligations to address concerns described above, in that information that is necessary to ensure that there is no material adverse effect on competition would have to be provided, without raising issues of commercial confidentiality or network security associated with publishing a reference offer. Additionally, the proposed conditions are transparent, in that they have been drafted so as to secure maximum transparency possible within the confines of commercial confidentiality and network security, which is aided by the explanation as to the intended operation and effect of the condition as set out in this document.

- ***Obligation to publish proposed changes to charges in advance of them taking place (proposed Condition MC6 and MD6)***

5.171 As with the requirement to supply Access Contracts, the publication of changes to charges in advance would have two main purposes: (a) to assist transparency for the monitoring of potential anti-competitive behaviour; and (b) to give advance warning of charge changes to providers purchasing wholesale access services competing with MNOs in the downstream markets. The latter is important to ensure that competing providers have sufficient time to plan for such changes, as they may wish to restructure retail prices in response to charge changes at the wholesale level. Advance publication would therefore help to ensure stability in markets. In its absence, incentives to invest might be undermined and market entry discouraged.

5.172 Advance publication of charges can have some disadvantages, particularly in markets where there is some competition, as it could discourage active price competition. For instance, competitors could see the published prices of the dominant provider and may choose to follow those prices rather than compete with them. Advance notification of price changes could result in price replication and therefore weaken competition. However, in the wholesale mobile voice call termination markets, in which SMP is persistent, these disadvantages are of little relevance. Publication of charge changes in advance is particularly important in the

relevant markets, as all PECN providers (MNOs and FNOs) – either directly or indirectly – have to buy call termination services from them.

5.173 On balance, the Director believes that the four MNOs should be required to publish proposed changes to charges for mobile voice call termination services (for 2G services only) in advance of those changes taking place.

5.174 Section 87(6)(b) of the Act authorises the setting of SMP service conditions that require a dominant provider to publish, in such manner as the Director may direct, all such information for the purpose of securing transparency. Section 87(6)(c) of the Act authorises the setting of SMP services conditions which require a dominant provider to publish, in such manner as the Director may from time to time direct, the terms and conditions on which he is willing to enter into an access contract.

5.175 The proposed conditions in the Notification at Annex C would require MNOs to publish price changes by sending to the Director and to every person with whom they have entered into an Access Contract a written notice of any amendments to the charges terms and conditions on which it provides network access. The condition also specifies the minimum number of days of advance notice of the changes that must be given before the change could come into effect, and the information to be included in that notice.

5.176 Having considered the May consultation responses, the Director believes that it is necessary to impose conditions on MNOs under which they would be required to give 28 days' advance notification before they would be permitted to change their charges in the markets for wholesale mobile voice call termination services (limited to 2G services only). This notice period reflects the persistence of SMP in those markets. The proposed conditions MC6 and MD6 are set out at Annex C. The Director believes that these conditions meet the tests set out in section 47 of the Act.

5.177 The Director, in proposing these conditions has considered all the Community requirements set out in section 4 of the Act, in particular the requirements to promote competition, secure efficient and sustainable competition and secure the maximum benefit for retail consumers. Furthermore, the Director has considered his general duties under section 3 of the Act, in particular the requirements to further the interests of citizens and to promote competition. In particular, this transparency obligation ensures that other PECN providers have advance sight of the charges for 2G voice call termination services provided by the MNOs in question. This helps ensure that competing PECN providers are able to take account of charge changes in order to compete with the MNO making the changes, whilst helping the Director to monitor other obligations such as the proposed charge control. The requirement therefore promotes competition, furthers the interests of consumers and citizens, and helps to secure effective and sustainable competition.

5.178 The Director believes that these conditions meet the tests set out in section 47 of the Act. Section 47 requires conditions to be justifiable, non-discriminatory, proportionate and transparent. The proposed conditions are objectively justifiable, in that prior publication of charge changes allows competing PECN providers to adapt to changes in wholesale charges and allows the monitoring of anti-competitive

behaviour. They do not discriminate unduly against MNOs, in that they apply equally to all those MNOs where the Director has a concern about potential anti-competitive behaviour. They are proportionate, in that only the minimum amount of information concerning call termination charges required by other network providers would have to be notified. Additionally, the proposed conditions are transparent, in that they have been drafted so as to secure maximum transparency, which is aided by the explanation as to the intended operation and effect of the condition as set out in this document.

Draft Decision

Inquam

- ***Obligation to publish proposed changes to charges in advance of them taking place (proposed Condition MB1)***

5.179 The publication of changes to charges in advance would assist transparency for the monitoring of potential anti-competitive behaviour and allows competing providers to have sufficient time to plan for such changes, as they may wish to restructure retail prices in response to charge changes at the wholesale level. Inquam holds a unique position as an MNO with the vast majority of calls terminated by it being on-net. Inquam also has a small customer base. Ex ante regulation should reflect this position i.e. it should be proportionate and appropriate, and whilst the Director currently considers that Inquam holds a position of SMP within the market for terminating voice calls on its network, his view is that Inquam is very unlikely to use this to generate the detrimental effects discussed in Chapter 4.

5.180 However, the Director is also of the view that by holding a position of SMP, some risk of detrimental effects, however small, remains. There is also the prospect that in the future Inquam's customer base could grow or change. Some monitoring of Inquam's performance and behaviour is therefore justified and whilst performance can be measured by market indicators such as customer base, the Director also considers a transparency obligation appropriate in order to assist with the monitoring of Inquam's behaviour.

5.181 On balance, the Director believes that Inquam should be required to publish proposed changes to charges for mobile voice call termination services in advance of those changes taking place.

5.182 Section 87(6)(b) of the Act authorises the setting of SMP service conditions that require a dominant provider to publish, in such manner as the Director may direct, all such information for the purpose of securing transparency. Section 87(6)(c) of the Act authorises the setting of SMP services conditions which require a dominant provider to publish, in such manner as the Director may from time to time direct, the terms and conditions on which he is willing to enter into an access contract.

5.183 The proposed condition in the Notification at Annex C would require Inquam to publish price changes by sending to the Director and to every person with whom it has entered into an Access Contract a written notice of any amendments to the

charges, terms and conditions on which it provides network access. The condition also specifies the minimum number of days' advance notice of the changes that must be given before the change could come into effect, and the information to be included in that notice.

5.184 The Director has considered the amount of notice that Inquam should be required to give before changing charges for wholesale voice call termination services and, as a result, believes that the notification period proposed in the May consultation is appropriate i.e. 28 days' notice.

5.185 This notice period reflects the persistence of SMP in those markets.

5.186 Therefore, having considered the May consultation responses, the Director believes that it is necessary to impose a condition on Inquam under which it would be required to give 28 days' advance notification before it would be permitted to change its charges in market for mobile voice call termination. Proposed condition MB1 is set out at Annex C.

5.187 The Director, in proposing this obligation has considered all the Community requirements set out in section 4 of the Act, in particular the requirements to secure efficient and sustainable competition and secure the maximum benefit for retail consumers. Furthermore, the Director has considered his general duties under section 3 of the Act, in particular the requirements to further the interests of citizens and to promote competition. In particular, this transparency obligation ensures both that the Director is able to monitor Inquam's behaviour in setting charges for 2G voice call termination and that other PECN providers have advance sight of its charges for 2G voice call termination services. By ensuring that competing PECN providers have the opportunity to see, and therefore react, to changes in charges, the requirement furthers the interests of consumers and citizens, and helps to secure effective and sustainable competition.

5.188 The Director believes that this condition meets the tests set out in section 47 of the Act i.e. the proposed condition is objectively justifiable, non-discriminatory, proportionate, and transparent. It is objectively justifiable, in that prior publication of charge changes allows competing PECN providers to adapt to changes in wholesale charges and allows the monitoring of anti-competitive behaviour. It does not discriminate unduly against Inquam, in that it in that it addresses concerns stemming from Inquam's SMP and is therefore justified. It is proportionate, in that only the minimum information that other network providers would need to know regarding Inquam's charges would have to be notified. Additionally, the proposed condition is transparent, in that it has been drafted so as to secure maximum transparency, which is aided by the explanation as to the intended operation and effect of the condition as set out in this document.

Draft Decision

'3'

- ***Obligation to publish proposed changes to charges in advance of them taking place and to provide the Director with details of charges for and***
-

volumes of 2G voice call termination on a quarterly basis (proposed Condition MA1)

5.189 The publication of charge changes in advance and the provision of call volume data to the Director would have the purpose of assisting transparency for the monitoring of potential anti-competitive behaviour, and allows competing providers to have sufficient time to plan for charge changes, as they may wish to restructure retail prices in response to such changes at the wholesale level.

5.190 The reporting requirement in relation to call volumes has few disadvantages for the new entrant, as it does not require publication to anyone except the Director of the requested information. It only requires that '3' collates and submits call volume information to the Director on a regular basis. The Director does not consider this to be unduly onerous, as the data should be readily available to '3'.

5.191 However, the Director believes that '3' should be required to publish, in advance, charge changes, both to the Director and those taking wholesale voice call termination services from '3'. This allows transparency and allows competing providers to have sufficient time to plan for charge changes, as they may wish to restructure retail prices in response to such changes at the wholesale level.

5.192 Section 87(6)(b) of the Act authorises the setting of SMP service conditions that require a dominant provider to publish, in such manner as the Director may direct, all such information for the purpose of securing transparency. Section 87(6)(c) of the Act authorises the setting of SMP services conditions which require a dominant provider to publish, in such manner as the Director may from time to time direct, the terms and conditions on which he is willing to enter into an access contract.

5.193 Having considered the May consultation responses, the Director believes that it is necessary to impose a condition on '3' under which it would be required to give 28 days' advance notification before it would be permitted to change its charges in market for mobile voice call termination. The condition also specifies the information on call volumes to be provided to the Director on a confidential basis each quarter.

5.194 The proposed condition MA1 is set out in the Notification at Annex C.

5.195 The Director, in proposing this obligation has considered all the Community requirements set out in section 4 of the Communications Act 2003, in particular the requirements to promote competition, to secure efficient and sustainable competition and secure the maximum benefit for retail consumers. Furthermore, the Director has considered his general duties under section 3 of the Act, in particular the requirements to further the interests of citizens and to promote competition. In particular, this transparency obligation allows competing PECN providers to adapt to changes in wholesale charges and allows the monitoring of anti-competitive behaviour. The obligation to provide call volume information allows '3' to provide information that would demonstrate that regulation applied to it continues to be appropriate and proportionate, without having to publish commercially sensitive material. Therefore, the Director proposes that '3' provides the relevant information to him, in order to allow transparency through the monitoring of call volumes. The

requirement therefore helps to promote competition, furthers the interests of consumers and citizens, and promotes effective and sustainable competition by providing competing PECN providers assurances that '3' continues to be appropriately and proportionately regulated.

5.196 The Director believes that this condition meets the tests set out in section 47 of the Act. The proposed condition is objectively justifiable, non-discriminatory, proportionate, and transparent. It is objectively justifiable, in that prior publication of charge changes allows competing PECN providers to adapt to changes in wholesale charges and allows the monitoring of anti-competitive behaviour, whilst notification of call volumes provides the transparency to ensure appropriate and proportionate regulation. It does not discriminate unduly against '3', in that it addresses problems stemming from '3's dominance in the market whilst reflecting '3's unique position as a new entrant offering 2G voice call termination only where its own 3G network cannot provide call termination services. It is proportionate, in that only the minimum amount of information required by the Director and competitors for monitoring purposes is required to be published, and in the case of call volumes, the information need only be made available to the Director. Additionally, the proposed condition is transparent, in that it has been drafted so as to secure the transparency requisite for the purposes of the condition, which is aided by the explanation as to the intended operation and effect of the condition as set out in this document.
