

Assessment of whether H3G
holds a position of SMP in the
market for wholesale mobile voice
call termination on its network

Statement

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Section 1

Summary

- 1.1 Wholesale mobile voice call termination (“MCT”) is the service purchased from mobile network providers by another communications provider so that they can connect their networks to enable their customers to contact the person they are calling. The recipient of the call will be answering using their mobile phone. If call termination was not available a communications provider could only terminate calls to other customers on its own network. This service is referred to as wholesale because it is sold and purchased by communications providers rather than retail customers.
- 1.2 In 2003, a new European regulatory framework for electronic communications networks and services entered into force, which was implemented in the UK via the Communications Act 2003 (‘the Act’).
- 1.3 In keeping with its requirements under the Act, Oftel and then Ofcom conducted a review of the extent of competition in the provision of wholesale mobile voice call termination. Following this market review, Ofcom, in June 2004, determined that there was a separate market for wholesale mobile voice call termination on the network of each of Vodafone, O2, T-Mobile, Orange and H3G (“the MNOs”) (plus Inquam, which has since ceased to trade). Those markets were considered to include voice call termination on both 2G and 3G networks, but they exclude termination of data and SMS. Ofcom also concluded that each MNO had Significant Market Power (‘SMP’) in its respective market.
- 1.4 On this basis, Ofcom imposed regulatory remedies on each of the operators for the period June 2004 to April 2006, with the 2G MNOs, Vodafone, O2, Orange and T-Mobile, being subject to charge controls and other requirements. H3G was required only to give advance notification of price changes and provide Ofcom with details of its call volumes. Inquam was subject to a requirement to give advance notification of its price changes.
- 1.5 H3G subsequently appealed Ofcom’s determination that it had SMP to the Competition Appeal Tribunal (‘the CAT’), on the grounds, amongst others, that Ofcom did not carry out a sufficient analysis to entitle it to come to a decision that H3G had SMP and, failed to take account or sufficient account, of the ability of BT to restrain pricing, in reaching its conclusions.¹
- 1.6 The CAT, in November 2005, found that Ofcom erred in its SMP determination since it did not conduct a full assessment of the extent to which BT had Countervailing Buyer Power (‘CBP’). It made an Order requiring Ofcom to:
 - Reconsider whether H3G has SMP in the market for mobile wholesale voice termination on H3G’s network taking into account the extent to which CBP exists in BT and any other matters as are relevant at the time of Ofcom’s reconsideration; and
 - Take account of the CAT’s Judgment in its reconsideration.

¹ See the CAT’s judgment, paragraph 35, (<http://www.catribunal.org.uk/documents/Jdq1047H3G281105.pdf>).

- 1.7 On 13 September 2006 Ofcom published the consultation document *Assessment of whether H3G holds a position of SMP in the market for wholesale mobile voice call termination on its network* (the 'H3G reassessment consultation')², reassessing H3G's position of SMP consistent with the Order made by the CAT.
- 1.8 In the H3G reassessment consultation, Ofcom proposed that H3G has SMP in the market for wholesale mobile voice call termination on its own network as:
- H3G has 100% market share of the relevant market;
 - There are absolute barriers to entry; and
 - Ofcom considered that BT did not and will not, over the period under consideration, have sufficient CBP to constrain H3G's prices to a competitive level.
- 1.9 Additionally, Ofcom proposed to impose a transparency obligation on H3G for the period until 31 March 2007.
- 1.10 This statement (the H3G reassessment statement) sets out Ofcom's decision in relation to the reassessment of H3G over this period.
- 1.11 Ofcom has today also published its final decision in relation to its review of Calls to Mobile³ for the period from 1st April to 31 March 2011.

Responses to the September H3G reassessment consultation

- 1.12 Ofcom received three responses to the H3G reassessment consultation; from the European Commission, H3G and O2. The Commission made no comment on Ofcom's analysis in its response.
- 1.13 O2 considered that Ofcom had carried out a thorough analysis and that there was empirical evidence to support Ofcom's view of the absence of sufficient CBP exerted by BT on H3G. O2 therefore agreed with Ofcom's proposal as set out in the H3G reassessment consultation that H3G has SMP in the relevant market.
- 1.14 H3G raised a number of issues in its response:
- H3G questioned Ofcom's interpretation of our dispute resolution powers. In H3G's view, the fact that BT can refer a pricing dispute to Ofcom of itself implies that BT constrains H3G's pricing independence.
 - H3G questioned Ofcom's view that in resolving a dispute, Ofcom's approach would vary according to whether or not an operator has SMP. In H3G's view, there is no legal justification for adopting such a distinction.
 - H3G disagreed with Ofcom's view that in resolving a dispute about end-to-end connectivity, where neither party has SMP, its main objective would be to ensure that connectivity (and, therefore, the outcome might be different from a dispute where one or both parties possessed SMP). Further, H3G questioned what price would be determined under these circumstances.

² See <http://www.ofcom.org.uk/consult/condocs/h3gsmp/>.

³ http://www.ofcom.org.uk/consult/condocs/mobile_call_term/statement

- H3G questioned Ofcom's view as to the extent to which CBP would have to act as a constraint on prices before it could be considered sufficient to counter SMP. H3G noted that, under competition law, dominance is considered to be shown by an ability to sustain prices that "substantially" exceed costs; the ability for prices to exceed the competitive level is not, of itself, an indication of dominance.
- More broadly, H3G also argued that Ofcom had erred by setting out the prima facie evidence of SMP before considering whether any purchaser is able to exercise sufficient CBP to counter that SMP. In H3G's view, this approach presents a risk that Ofcom would fail to give adequate consideration to all the factors relating to countervailing buyer power.

1.15 In summary, H3G continues to consider that BT has CBP, and that it does not have SMP in the relevant market.

1.16 Ofcom has taken these responses into account in reaching its decision, and its response to each of the issues raised by H3G is set out in the relevant sections of this document. In particular, Ofcom responds to H3G's points regarding dispute resolution and end-to-end connectivity in paragraphs 3.8 and paragraphs 4.56 to 4.74 and in relation to the extent of CBP held by BT 4.15 to 4.50. Section 5, in particular paragraphs 5.10 to 5.15 set out the SMP criteria relevant to this analysis.

Assessment of whether BT has CBP

1.17 In accordance with the CAT's Judgment and Order, in arriving at its decision as set out in this statement, Ofcom has considered and taken account of all the available evidence which relates to the relative positions of BT and H3G in negotiating the price that H3G would charge and charges BT for mobile voice call termination on its network.

1.18 Such evidence includes that relating to the initial negotiations between H3G and BT to the extent it continues to have relevance in the period under consideration, any further material following the initial negotiations and the effect that any prospect of relevant regulatory intervention may have on BT's CBP.

Conclusion on CBP

1.19 Over the period from 1 June 2004 to 31 March 2007, given H3G's 100% market share in the market for wholesale mobile voice call termination on its own network, and the absolute barriers to entry to that market, Ofcom's view is that BT has not been able and is unlikely to be able to exert CBP through a threat either to purchase the service from an alternative source or to self-supply.

1.20 BT is a well-informed purchaser of termination services and is likely to be increasingly price sensitive to the charge for termination on H3G's network as H3G grows. However, BT is not currently in a position to constrain the price it must pay H3G by credibly threatening to delay a price notification aiming at a charge increase, or to cease purchasing termination from H3G. This is a result of the provisions in the current contract between BT and H3G and BT's end-to-end connectivity obligation. In relation to the contract, these provisions include timelines within which proposed price changes have to be accepted or rejected. Furthermore, since H3G has grown significantly since the establishment of the interconnection agreement between H3G and BT, BT's commercial incentive to cease purchasing termination will have decreased substantially.

- 1.21 Should a stalemate situation occur in terms of negotiating H3G's termination rate between H3G and BT, both parties could refer the issue as a dispute to Ofcom and in this context, BT would have no certainty as to the outcome of dispute resolution by Ofcom. Importantly, the range of potential charges set in the context of an end-to-end dispute is wide, and a reasonable charge in that context would likely be appreciably above the competitive level.
- 1.22 Over time, H3G's mobile voice call termination rates have remained stable, although the termination charges of the other 2G MNOs have been reduced substantially. The evidence shows that the level of CBP held by BT is unlikely to be sufficient to counter H3G's pricing power due to its 100% market share and the absolute barriers to entry.
- 1.23 Ofcom notes that during the period between publication of the H3G reassessment consultation and publication of this statement, negotiations between BT and H3G regarding H3G's charges for provision of MCT have reached an impasse. BT has since referred a dispute in relation to these charges to Ofcom.

Other relevant SMP criteria

- 1.24 As part of Ofcom's reconsideration of whether H3G has SMP in the relevant market Ofcom also revisited the full range of relevant factors to determine whether there have been any changes since the assessment set out in Ofcom's June 2004 CTM statement. The relevant factors in 2004, in addition to CBP, were (i) market shares, (ii) the absence of potential competition and (iii) excessive pricing and profitability, which was used only in relation to the SMP findings on the 2G MNOs, not in relation to H3G.
- 1.25 In considering these factors for the purposes of this re-assessment, Ofcom considers that:
- H3G continues to have 100% market share of the relevant market; and
 - There are absolute barriers to entry which Ofcom believes will persist through to at least April 2007 and which would preclude effective potential competition.

Conclusion

- 1.26 Ofcom has determined that H3G has SMP in the market for wholesale mobile voice call termination on its own network. H3G has 100% market share of the relevant market and there are absolute barriers to entry. Following further analysis of CBP and having reviewed the responses to the H3G reassessment consultation and taking into account the further information provided by BT and H3G in relation to negotiations for the supply of MCT, Ofcom considers that BT did not and will not, over the period under consideration, have sufficient CBP to constrain H3G's prices to a level that is not appreciably above the competitive level.
- 1.27 In light of this conclusion, Ofcom by this statement designates H3G as having SMP in the market for wholesale mobile voice call termination provided by H3G (such termination being provided via H3G's mobile network), over the period from 1 June 2004 to 31 March 2007.
- 1.28 As a consequence of which, Ofcom has set a transparency obligation on H3G for the period until 31 March 2007.

Section 2

Background and introduction

Background

- 2.1 Wholesale mobile voice call termination (“MCT”) is the service purchased by a network operator so that they can connect their customers with the person they are calling who is on a different mobile network. If voice call termination, generally, was not available a network operator could only terminate calls to other customers connected to its own network. This service is referred to as wholesale because it is sold and purchased by network operators rather than retail customers.
- 2.2 Under the Framework Directive (Directive 2002/21/EC), the European Commission has adopted a Recommendation on relevant products and services markets (“the Recommendation”)⁴ which identifies markets within the electronic communications sector, the characteristics of which may be such as to justify the imposition of regulatory obligations. National Regulatory Authorities (NRAs) such as Ofcom are obliged to take the utmost account of the Recommendation when defining markets. If Ofcom considers that a market it has reviewed is not effectively competitive, it must consider imposing remedies where appropriate on undertakings with SMP within that market. The Recommendation’s Market 16 is the market for voice call termination on individual mobile networks.
- 2.3 Ofcom last conducted a full review of the market for mobile voice call termination during 2003/4. Ofcom published a statement entitled *Wholesale Mobile Voice Call Termination* on 1 June 2004 (“the June 2004 CTM statement”) in which it concluded that, as envisaged by the European Commission in its Recommendation, there are separate markets for mobile termination of voice calls on the network(s) of each of Vodafone, O2, T-Mobile, Orange and H3G (“the five MNOs”) (plus Inquam which has since ceased to trade). Those markets were considered to include voice call termination on both 2G and 3G networks, but they excluded termination of data and SMS. The June 2004 Statement also found that each of the five MNOs (plus Inquam) had SMP in their respective market. The SMP conditions imposed were as follows:
- 2.4 In respect of Vodafone, O2, T-Mobile and Orange for their 2G voice call termination services:
- i) a charge control, to last until 31 March 2006;
 - ii) the provision of network access on reasonable request;
 - iii) the requirement not to unduly discriminate in relations to matters connected with such network access;
 - iv) the requirement to supply to Ofcom copies of any new or amended access contracts; and

⁴ *Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services.*

http://europa.eu.int/information_society/topics/telecoms/regulatory/publicconsult/documents/relevant_markets/l_11420030508en00450049.pdf

- v) the requirement to give advance notification of price changes.
- 2.5 In respect of wholesale mobile voice call termination services provided by Inquam, a requirement to give advance notification of price changes.
- 2.6 In respect of wholesale mobile voice call termination services provided by H3G, a requirement to give advance notification of price changes and supply information to Ofcom with respect to call volumes.
- 2.7 H3G subsequently appealed Ofcom's determination that it had SMP to the Competition Appeal Tribunal ('the CAT'). The CAT gave its judgment concerning H3G's appeal on 29 November 2005 ('the CAT's judgment'), finding that "Ofcom erred in its determination as to the existence of SMP because it did not carry out a full assessment of the extent to which BT had Countervailing Buyer Power (CBP)." In an order drawn on 10 March 2006 the CAT remitted to Ofcom for reconsideration "as to whether the Appellant (H3G) has significant market power in the market for mobile wholesale voice call termination on the Appellant's network taking into account the extent to which countervailing buyer power exists in the Intervener (BT) and any other matters as are relevant at the time of Ofcom's reconsideration." Annex 1 provides an overview of the CAT's judgment and evidence submitted to it as well as the initial agreement between H3G and BT in respect of MCT and the CAT's Judgment following H3G's appeal.
- 2.8 On 30 March 2006, Ofcom published a consultation document ('the March 2006 CTM review consultation')⁵ setting out its initial views on market definition, SMP and the options for future regulation of mobile voice call termination after 31 March 2007. This consultation document set out, among other things, Ofcom's proposed view that:
- As found in the June 2004 CTM statement, there are separate markets for mobile voice call termination for each of the UK MNOs (i.e. Vodafone, O2, T-Mobile, Orange and H3G);
 - The prima facie evidence indicates that each of these mobile operators has SMP, i.e. the ability and incentive to set charges appreciably above the competitive level;
 - These market definitions and the existence of SMP are unlikely to change during the time frame of the forward looking CTM review (4 years from 1 April 2007).
- 2.9 Having considered responses to the March 2006 CTM review consultation, and having completed an analysis of CBP, Ofcom set out in a further consultation document, published on 13 September 2006, *Mobile call termination – Proposals for consultation* (the 'September 2006 CTM review consultation')⁶ its formal proposal in respect of market definition, SMP and appropriate remedies for wholesale mobile voice call termination for the period from April 2007 to March 2011. The subsequent and final statement on mobile call termination is published today.

Introduction

- 2.10 On 13 September 2006 Ofcom also published the consultation document *Assessment of whether H3G holds a position of SMP in the market for wholesale*

⁵ See <http://www.ofcom.org.uk/consult/condocs/mct/>.

⁶ See http://www.ofcom.org.uk/consult/condocs/mobile_call_term/.

mobile voice call termination on its network (the 'H3G reassessment consultation').⁷ In the H3G reassessment consultation, which covers the period up to the end of March 2007, Ofcom set out its preliminary views that H3G has SMP in the market for wholesale mobile voice call termination on its own network on the basis that:

- H3G has 100% market share of the relevant market;
- There are absolute barriers to entry; and
- Ofcom considered that BT did not and will not, over the period under consideration, have sufficient CBP to constrain H3G's prices to a competitive level.

2.11 Additionally, Ofcom proposed to impose a transparency obligation on H3G for the period until 31 March 2007.

Responses to the H3G reassessment consultation

2.12 Ofcom received three responses in respect of the H3G reassessment consultation; they were from the European Commission, O2 and H3G.

2.13 The European Commission had no comments regarding Ofcom's analysis. O2 considered Ofcom had carried out a thorough analysis and that there is empirical evidence to support Ofcom's view on the absence of sufficient CBP exerted by BT. In the context of Ofcom's proposed market definition, O2 therefore agrees with Ofcom's proposal that H3G has SMP in the relevant market.

2.14 H3G raised a range of issues in its response which are dealt with in the relevant sections of this document.

2.15 H3G questioned Ofcom's interpretation of its dispute resolution powers. In H3G's view, the fact that BT can refer a pricing dispute to Ofcom of itself implies that BT constrains H3G's pricing independence.

2.16 H3G also questioned Ofcom's view that in resolving a dispute Ofcom's approach would vary according to whether or not an operator has SMP. In H3G's view, there is no legal justification for adopting such a distinction. H3G disagrees with Ofcom's view that in resolving a dispute about end-to-end connectivity, where neither party has SMP, its main objective will be to ensure that connectivity (and, therefore, the outcome might be different from a dispute where one or both parties have SMP). Further, H3G questioned what price would be determined in these circumstances. In H3G's view, if Ofcom were to set an excessive charge, it would be in breach of its duties to promote competition and efficiency.

2.17 In addition, H3G questioned Ofcom's view of the extent to which CBP would have to act as a constraint on prices before it could be considered sufficient to counter SMP. H3G noted that, under competition law, dominance is considered to be shown by an ability to sustain prices that "substantially" exceed costs; the ability to exceed the competitive level is not of itself an indication of dominance.

2.18 More broadly, H3G also argued that Ofcom had erred by setting out the prima facie evidence of SMP before considering whether any purchaser is able to exercise sufficient CBP to counter that SMP. In H3G's view, this approach presents a risk that

⁷ See <http://www.ofcom.org.uk/consult/condocs/h3gsmp/>.

Ofcom would fail to give adequate consideration to all the factors relating to countervailing buyer power.

- 2.19 In summary, H3G continues to consider that BT has countervailing buyer power and that H3G does not have SMP. Ofcom has taken these responses into account in reaching its decision, and its response to each of the issues raised by H3G is set out in the relevant sections of this document, as identified in paragraph 1.16 above.

Scope of this statement

- 2.20 Having considered responses to the H3G reassessment consultation, this statement sets out Ofcom's conclusions on whether H3G has SMP in the market for mobile termination of voice calls on its own network, and whether any remedy should be imposed.

- 2.21 This statement and the H3G reassessment consultation follow on from the CAT's judgment referred to above. In that judgment, the CAT made an order, consented to by all parties, on 16 December 2005 and subsequently drawn on 10 March 2006 requiring Ofcom to:

- Reconsider whether H3G has SMP in the market for mobile wholesale voice termination on H3G's network taking into account the extent to which CBP exists in BT and any other matters as are relevant at the time of Ofcom's reconsideration; and
- Take account of the CAT's judgment in its reconsideration.⁸

- 2.22 A consideration of whether H3G holds SMP requires Ofcom to assess whether H3G:

“enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers.”⁹

- 2.23 The CAT noted that Ofcom had found that H3G had a 100% market share and there were absolute barriers to entry in the market for wholesale voice call termination on H3G's mobile network. It found that:

“It was against the background of these strong prima facie indicators of SMP that Ofcom reached its decision, in June 2004, that there was no effective competition in that market, and accordingly concluded that H3G had SMP.” The CAT went on to state that “nonetheless it was for Ofcom to analyse whether there was sufficient CBP in the market to negate the finding of SMP” and the CAT took the view that, “on that one aspect of its decision, Ofcom did not meet the standard required of it.”¹⁰

- 2.24 Accordingly, Ofcom, in reconsidering that part of its decision in June 2004 relating to CBP has done so in the context of the previous findings and taking account of the fact that:

⁸ See the CAT's order drawn on 10 March 2006, paragraphs 1 and 2.

⁹ Article 14(2) of the Framework Directive. (See http://europa.eu.int/eurlex/pri/en/oj/dat/2002/l_108/l_10820020424en00330050.pdf)

¹⁰ See the CAT's judgment, paragraph 23.

- the relevant market is that for wholesale mobile voice call termination on H3G's network;
- H3G has a 100% market share on that market; and
- there are absolute barriers to entry on that market and therefore no effective potential competition.¹¹

2.25 In reconsidering whether BT has sufficient CBP to negate the finding of SMP, Ofcom has looked, in particular, at:

- Any material from prior negotiations between H3G and BT in respect of wholesale mobile voice call termination on H3G's network which might have continuing relevance in any price negotiation between H3G and BT;
- The further material relating to the relationship between H3G and BT regarding wholesale mobile voice call termination following the establishment of the original agreement which may have relevance to assessing the degree of CBP held by BT; and,
- The effect that any prospect of regulation may have on the degree of CBP held by BT, considering the end-to-end connectivity regulatory obligation imposed on BT.¹²

2.26 Ofcom has also considered whether the factual circumstances have changed significantly in any respect since its June 2004 CTM statement, such that its conclusions as to whether H3G has SMP would be affected. Where appropriate, Ofcom has relied on evidence and analysis in the context of its May 2003 CTM review consultation ('the May 2003 CTM review consultation'), December 2003 CTM review consultation ('the December 2003 CTM review consultation'), June 2004 statement ('the June 2004 CTM statement', the March 2006 CTM review consultation ('the March 2006 CTM review consultation') and the September 2006 CTM review consultation ('the September 2006 CTM review consultation').

Outline of this document

2.27 This statement should be read in conjunction with Ofcom's June 2004 CTM statement and its preceding May 2003 CTM review consultation and December 2003 CTM review consultation, which set out Ofcom's reasoning with respect to those aspects of its June 2004 CTM statement relating to H3G which were not contested, i.e. the relevant market being the market for wholesale mobile voice call termination on H3G's network, H3G having a 100% market share on that market and there being absolute barriers to entry to that market and therefore no effective potential competition. The remainder of this document is structured as follows:

- Section 3 describes the regulatory criteria relevant to assess CBP and discusses the factual background to the negotiations between BT and H3G;
- Section 4 sets out Ofcom's assessment of the economic factors and its conclusion as to whether BT has CBP in purchasing wholesale mobile voice call termination services from H3G, and if so, the extent of its CBP;

¹¹ None of which were contested by H3G in its appeal.

¹² http://www.ofcom.org.uk/consult/condocs/end_to_end/statement/statement.pdf

- Section 5 considers whether there have been any changes to the other relevant SMP criteria or factors since the June 2004 CTM statement;
- Section 6 sets out the regulatory remedies proposed by Ofcom;
- Annex 1 provides details as to the CAT's judgment and evidence submitted to it as well as the negotiation of the initial agreement between H3G and BT;
- Annex 2 sets out recent developments in respect of H3G's mobile voice call termination rate; and
- Annex 3 contains the Notification under sections 48(1) and 79 (4) of the Act, containing Ofcom's market power determination and the setting of SMP services conditions in relation to H3G.

Section 3

Relevant factors to assess CBP

3.1 As discussed at paragraphs 2.24 to 2.26 above, the question of whether in providing MCT H3G has SMP depends on the extent to which its position of SMP may be off-set by the buyer power of purchasers of MCT.

3.2 The Commission notes in its Explanatory Memorandum ('EC Memorandum') to its Recommendation on Market Definition,¹³ that a market definition of call termination on individual networks:

"...does not automatically mean that every network operator has significant market power; this depends on the degree of any countervailing buyer power and other factors potentially limiting that market power."¹⁴

3.3 Countervailing buyer power ('CBP') is not an absolute concept but, rather, refers to the relative strength of the buyer in its negotiations with the prospective seller for the good or service in question. It exists when a particular purchaser (or group of purchasers) of a good or service is sufficiently important to its supplier to influence the price charged for that good or service. The Commission notes in its EC Memorandum that:

"A market definition for call termination on each mobile network would imply that currently each mobile network operator is a single supplier on each market. However, whether every operator then has market power still depends on whether there is any countervailing buyer power, which would render any non-transitory price increase un-profitable."¹⁵

Ofcom's response to specific points raised by H3G

3.4 Ofcom considers that in this context, the test to assess whether CBP is sufficient to prevent the exercise of SMP is that set out in Article 14 (2) of the Framework Directive, namely: whether CBP can constrain an MCT provider from having the "power to behave to an appreciable extent independently of competitors, customers and ultimately consumers".

3.5 Ofcom considers therefore that the relevant test for SMP relates to an ability to sustain charges appreciably above the competitive level, as envisaged by Article 14 (2) above. Though Ofcom notes H3G's observation set out at paragraph 1.14 above, where it states that the ability for prices to exceed the competitive level is not of itself an indication of dominance, the test is the ability to sustain prices that "substantially

¹³ Explanatory Memorandum to the Commission Recommendation on Relevant Product and 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services. (See http://europa.eu.int/information_society/policy/ecomms/doc/info_centre/recomm_guidelines/relevant_markets/en1_2003_497.pdf)

¹⁴ Page 20.

¹⁵ Page 34.

exceed costs'. Ofcom considers that this approach is in line with that relied on by Ofcom in the H3G reassessment consultation, and in this statement.¹⁶

- 3.6 H3G in its response argued that Ofcom had erred by setting out the *prima facie* evidence of SMP before subsequently considering whether any purchaser is able to exercise sufficient CBP to counter that SMP. In H3G's view, this approach presents a risk that Ofcom would fail to give adequate consideration to the countervailing factors.
- 3.7 Ofcom does not accept H3G's view that there is any error involved in considering the *prima facie* evidence of SMP before considering the existence of CBP. The fact that there is only one supplier of termination on each mobile network indicates that, on the basis of market shares alone, one would expect to find dominance in this market. Having noted this prominent factor, Ofcom has then fully considered all other relevant factors, including the possibility that BT has CBP. Furthermore, Ofcom does not accept that, in practice, this approach has meant that Ofcom has not sufficiently analysed the countervailing factors. As set out below, the detailed evidence presented in this Section and Section 4 is not consistent with the view that Ofcom has failed to undertake sufficient analysis.
- 3.8 In response to H3G's comments as to how Ofcom would resolve a dispute between an MNO and BT, Ofcom explains at paragraphs 4.64 – 4.66, if a charge appreciably above the competitive level were in dispute, Ofcom considers it unlikely that it would impose a charge in the context of such a dispute that was not appreciably above the competitive level.
- 3.9 H3G has also argued in its response, that it considers that in determining that BT may not refuse a request to purchase MCT even where the charge proposed is above cost, Ofcom may not be acting in accordance with its duty to promote competition under Article 8 (2) of the Framework Directive (policy objectives and regulatory principles). Ofcom notes that Article 8 (2) mentions as a subset that Ofcom shall ensure that users derive maximum benefit in terms of choice, price and quality. Therefore, the purpose of BT's obligation to meet reasonable requests to purchase MCT is to ensure end to end connectivity (and thus ensuring users can talk to each other) and a dispute would be considered in that light.
- 3.10 The remaining structure of this section is as follows.
- 3.11 First, at paragraphs 3.13 to 3.46, Ofcom identifies the regulatory factors relevant to the analysis of CBP.
- 3.12 Second, at paragraphs 3.47 to 3.54, Ofcom sets out evidence relevant to its enquiry. Ofcom considers BT's position as the largest purchaser of MCT, both for calls originating on its own network and for traffic which other originating operators pay it to transit via its network. Ofcom also considers evidence of:
- a) the contracts for MCT concluded between H3G and BT; and
 - b) the negotiations of charge changes in respect of MCT charges.
- in order to determine to what extent it may assist in assessing CBP.

¹⁶. See for example paragraph 4.3 <http://www.ofcom.org.uk/consult/condocs/h3gsmp/h3gsmp.pdf>.

Regulatory factors and issues raised by stakeholders

Regulation of the party being assessed for SMP

- 3.13 As Ofcom set out in the H3G re-assessment consultation in assessing whether H3G has SMP, it is necessary to conduct the analysis on the basis that no SMP related regulation currently exists on that provider in the market being reviewed. However, regulation which will continue to exist throughout the period of the forward-looking assessment independently of an SMP finding on the market concerned, must be taken into account.
- 3.14 This approach is consistent with the analysis adopted by the European Commission in its decision requiring the German regulator, RegTP, to withdraw notified draft measures in respect of fixed call termination. The Commission accepted the appropriateness of discounting regulatory constraints upon the market power of the party being assessed for SMP, a mode of analysis described as “the Modified Greenfield Approach”:

“The purpose of a Greenfield approach is indeed to avoid circularity in the market analysis by avoiding that, when as a result of existing regulation a market is found to be effectively competitive, which could result in withdrawing that regulation, the market may return to a situation where there is no longer effective competition. In other words, any Greenfield approach must ensure that absence of SMP is only found and regulation only rolled back where markets have become sustainably competitive, and not where the absence of SMP is precisely the result of the regulation in place. This implies that *regulation which will continue to exist throughout the period of the forward-looking assessment independently of a SMP finding on the market concerned, must be taken into account.*” (Emphasis added)¹⁷

- 3.15 The CAT adopted the same approach in its judgment in the H3G case and explained the above passage in the following terms.

“In other words, a potentially regulated person cannot claim that it does not have SMP because regulation has procured a situation in which it no longer has it. So long as it is regulation which is bringing about competitive outcomes, the markets are not competitive independently of that regulation. It follows that the potentially regulated person cannot say that it does not have SMP because the threat of regulation means that it does not have the necessary power. That would be circular and illogical.”¹⁸

- 3.16 The CAT went on to state that:

“The effect of this is that the possibility of regulation being brought to bear on H3G is a factor that cannot be prayed in aid by H3G as militating against its having SMP. We reiterate that H3G’s submissions would give rise to an illogical and unattractive, if not an unprincipled, position, and we consider them to be wrong. The correct position is as found in the RegTP decision, namely that

¹⁷ Commission Decision of 17 May 2005, case DE/2005/0144,c(2005)1442 final, Paragraph 23.

¹⁸ H3G judgment, paragraph 98

regulatory obligations on a market counterparty can be taken into account, but not the potential for regulation on the party whose market position is under consideration.”¹⁹

- 3.17 When dealing with Ofcom’s power to resolve disputes as to the terms and conditions of MCT under the interconnection agreement between BT and H3G, the CAT also stated that:

“[Ofcom’s] intervention would... be as regulator, and would be a form of regulation. It therefore falls to be disregarded, as a matter of principle, just as Ofcom’s general presence as a regulator with a potential effect on the conduct of the putatively regulated person falls to be disregarded for the reasons given above.”²⁰

Regulation of the party being assessed for CBP

- 3.18 The issue of which regulation Ofcom should take into account also arises in determining whether any undertaking has CBP and the same principles apply i.e. pre-existing SMP regulation in the market being reviewed should be disregarded and regulation which will continue to exist throughout the period of the forward-looking assessment independently of a SMP finding on the market concerned should be considered. Given this, Ofcom has identified the following regulatory factors which are relevant to an assessment of CBP:

- control of fixed termination rates and other services;
- carrier pre-selection and indirect access obligations;
- General Condition 1.1; and
- BT’s end-to-end connectivity obligation and Ofcom’s dispute resolution powers in relation to this obligation (pursuant to section 185(2) of the Communications Act 2003).

Controls on supply of fixed termination services and other services

- 3.19 Telephone networks generally negotiate termination charges with each other on a bilateral basis. This is because customers on one network would look unfavourably on a situation where they were either not able to make calls to customers on another network, or were able to make calls to customers on another network but were unable to receive calls from them. However, when considering the impact such reciprocity may have on countervailing buyer power in this market, it is important to note that the termination charges of BT are constrained by regulation.
- 3.20 Absent regulation, the extent of BT’s buyer power when purchasing MCT will be influenced by the extent to which it can take into account the prices it charges for its own services as part of the negotiations. For example, BT, with a market share of around three-quarters of fixed network exchange lines²¹, might potentially be able to exert significant bargaining power in respect of an MNO’s price for MCT by varying, or threatening to vary, its charge for fixed network termination in response to

¹⁹ H3G judgment paragraph 99

²⁰ H3G Judgment, paragraph 138

²¹ Source: Ofcom Telecommunications Market Data Tables Q1 2006.

<http://www.ofcom.org.uk/research/cm/sep06/tablesep06.pdf>

proposals for mobile termination charges. However, BT's termination rate is determined by regulation²². As a consequence, the price BT charges an MNO for termination on BT's network cannot influence the negotiations of the price the MNO charges BT for MCT on its network. It cannot therefore be considered to be a source of BT's bargaining strength.

- 3.21 Similarly, where BT sells other services, for instance leased lines, to an MNO, it might be able to adjust the terms on which it sells those services in the course of negotiation of the mobile call termination rate with the MNO. However, where BT has SMP (such as for example in the markets for leased lines) it is constrained by regulation from unduly discriminating.
- 3.22 Such controls imposed on BT constrain the exercise of SMP in fixed network call termination markets, both by preventing the providers from setting excessive charges in those markets and by preventing them from leveraging that power into other markets (for example through reciprocal bargaining). The effect on BT's CBP in the market for MCT is considered in paragraphs 3.47-3.52 below.
- 3.23 The appropriateness of taking account of such regulation on BT when determining the extent, if any, of their CBP, is confirmed by the Commission's decision requiring the withdrawal of draft measures notified by RegTP, cited above. At paragraph 36, the Commission reasons as follows:

"It is generally considered that countervailing buyer power of a large operator is essentially lost if its call termination rates are additionally regulated in the separate market for call termination on that operator's individual public telephone network. DTAG's call termination rates are currently regulated and it is the Commission's understanding that they will continue to be regulated as a consequence of RegTP's finding that DTAG has SMP on the market for call termination on its network. In view of DTAG's own termination rates being regulated and given that it cannot realistically threaten to stop purchasing termination services (as set out above), DTAG would therefore be deprived of any bargaining tool in the form of a corresponding increase in its own tariffs when negotiating termination rates on that ANO's network."

Carrier Pre Selection and Indirect Access

- 3.24 BT is obliged by existing regulation to provide CPS and IA services to other Electronic Communications Providers who wish to offer retail call services to consumers. The purpose is to stimulate competition in the calls market and enhance competition in areas with only limited direct access competition.
- 3.25 CPS is a mechanism that allows users to select, in advance, alternative communications providers to carry their calls without having to dial a prefix. The customer subscribes to the services of one or more CPS operators ("CPSOs") and chooses the type of calls (e.g. all national calls) to be routed through the network of the alternative operator. A customer can over-ride the CPS service at any time by dialling a prefix before the number they wish to dial, as long as they have an agreement with the operator to whom the prefix code belongs.

²² See <http://www.ofcom.org.uk/consult/condocs/charge/statement/>

- 3.26 IA is a mechanism that allows users to select alternative communications providers to their access line provider on a call-by-call basis by dialling a short pre-fix before each number they wish to dial.
- 3.27 While the purpose of these conditions is to promote competition in a range of markets downstream from wholesale call origination, they also have a specific impact on the retail market for calls to mobiles. The ability of consumers to switch to alternative CPS or IA based providers of such calls may weaken BT's ability to threaten to cease purchasing wholesale MCT. The effect on BT's CBP in the market for MCT is considered in paragraphs 3.47-3.52 below.
- 3.28 The appropriateness of taking account of such regulation is confirmed by the Commission's decision requiring the withdrawal of draft measures notified by RegTP, cited above. At paragraph 28, the Commission notes as a relevant factor when assessing the CBP of DTAG that:

"... if DTAG were to cease to purchase termination from ANOs, this may have the effect of stimulating substitution via carrier selection. There are several long distance carrier (pre-) select operators on the German retail calls markets which are eager to capture market share. In the presence of such carrier (pre-) select operators, a refusal by DTAG to offer its customers certain retail calls services – namely calls to the subscribers of ANOs which DTAG no longer wants to purchase termination services from – could lead DTAG's retail customers to switch to these carrier (pre-) select operators for making such calls. DTAG's retail customers could thus use such carrier (pre-) selection operators to by-pass calls – whose ubiquitous coverage is no longer guaranteed by DTAG – provided of course that those operators are directly or indirectly interconnected with the ANO in question. In such a case, DTAG would lose market share in a core area of its business."

General Condition 1.1

- 3.29 Ofcom has also considered whether General Condition 1.1 should be viewed as relevant existing regulation. However, as this is a condition which imposes an obligation on providers of Public Electronic Communications Networks to *negotiate* interconnection rather than to interconnect, it is Ofcom's view that it would not have a material impact on the level of CBP held by purchasers of MCT.

End to end connectivity

- 3.30 End-to-end connectivity describes the ability of consumers to make calls to other customers or services on the same network or other providers' networks. This is a key feature that customers expect; they want to be able to call everyone with a telephone and not just a subset of that group.
- 3.31 In the H3G re-assessment consultation document, we gave an overview of the relevant changes with respect to BT's end-to-end connectivity obligation and Ofcom's dispute resolution powers during the relevant time period. None of the respondents commented on this.

The end-to-end connectivity obligation

- 3.32 It has always been Ofcom's (and previously Oftel's) policy objective to ensure end-to-end connectivity and in order to implement this, different legal and policy provisions have been introduced over time.
- 3.33 The first relevant time period to the H3G reassessment consultation is the period up to November 2003. In this time period and prior to the establishment of the initial agreement between BT and H3G, the old regulatory regime was still in place. Under this regime, BT had to provide end-to-end connectivity under Condition 45 of its licence.
- 3.34 BT's licence obligations at the relevant time contained, among other things, obligations to enter into an interconnection agreement with any operator that required it within a reasonable period (Condition 45.1) on terms and conditions which were reasonable (Condition 45.3) and in compliance with any directions given by the Director, including any made at the request of the operator (Condition 45.2 and 45.5).
- 3.35 In case of non-compliance, Oftel would have the ability to intervene under Article 9 of the (now repealed) Interconnection Directive²³ which had been implemented by the (Telecommunications) Interconnection Regulations.²⁴
- 3.36 BT's Licence Condition 45 was discontinued in November 2003 through various discontinuation notices published at the same time as the Director's Market Reviews.²⁵
- 3.37 In May 2003, prompted by the pending introduction of the new regulatory framework, Oftel published guidance on this issue entitled *End-to-end connectivity – Guidance issued by the Director General of Telecommunications*.²⁶ In summary, the guidance stated that among other things:
- “Oftel proposes to continue the existing policy that USO providers (BT and Kingston), in meeting reasonable requests to provide access to PATS, must ensure that their customers can call other customers and services irrespective of terminating network, that is they must provide end-to-end connectivity.”²⁷
- 3.38 In the event that unreasonable terms are proposed to it, BT could seek to negotiate, and ultimately, would be able to have recourse to previously Oftel and now Ofcom in order to resolve a dispute as to that charge.²⁸
- 3.39 Oftel's guidance on end-to-end connectivity stated that BT (and Kingston in the Hull area) was required to provide end-to-end connectivity based on the Universal Service

²³ See OJ No L199/32, 26 July 1997.

²⁴ <http://www.opsi.gov.uk/si/si1997/19972931.htm>

²⁵ See for example

http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/fixedenarrowbandstatement.pdf

²⁶ This document is available at:

http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/endcon0503.htm

²⁷ Ibid, paragraph 2.10.

²⁸ Ibid, paragraph 2.16.

Directive.²⁹ However, as set out in the statement on End-to-end connectivity,³⁰ on closer examination of the requirement in the Universal Service Directive, Ofcom is not satisfied that it could effectively enforce that requirement against BT as a means to ensure end-to-end connectivity if BT decided not to purchase wholesale narrowband (whether fixed, mobile, voice or data) call termination services from any operator that wished to sell such service to BT.

- 3.40 Ofcom proposed to remedy this situation by imposing an obligation on BT in order to ensure end-to-end connectivity.
- 3.41 The statement entitled *End-to-end connectivity* published on 13 September 2006, gives effect to Ofcom's proposal in the consultation document on End-to-end connectivity and imposes an obligation on BT to provide end-to-end connectivity.
- 3.42 With the objective of ensuring end-to-end connectivity, Ofcom has imposed on BT an access related condition³¹ which requires BT:
- To purchase wholesale narrowband (fixed and mobile voice and narrowband data) call termination services from any provider of public electronic communications networks ('PECN') that reasonably requests in writing that BT purchases such services;
 - To ensure that the purchase of the wholesale narrowband (fixed and mobile voice and narrowband data) call termination services shall occur as soon as reasonably practicable and shall be on reasonable terms and conditions (including charges), and on such terms and conditions (including charges) as Ofcom may from time to time direct;
 - To ensure that after purchasing wholesale narrowband (fixed and mobile voice and narrowband data) call termination services, BT will not be able to unreasonably change, withdraw or restrict access to an applicable Normal Telephone Number; and
 - To comply with any direction Ofcom may make from time to time under this Condition.
- 3.43 When Ofcom imposed this condition on BT, Ofcom noted that it did not consider that it was proportionate to impose a similar obligation on other providers of Public Electronic Communications Services. However, Ofcom considered that all providers should provide end-to-end connectivity and therefore if Ofcom became aware that this was not being provided Ofcom would consider whether such an obligation were appropriate and proportionate in that case.³²
- 3.44 If the obligation on BT was to provide end-to-end connectivity whatever the terms proposed by MNO's, it would eliminate any CBP on BT's part. However, the obligation on BT is to purchase MCT on reasonable terms and conditions. If BT and an MNO are unable to agree the terms and conditions on which MCT is to be

²⁹ Ibid, paragraph 2.8.

³⁰ See Ofcom Statement 'End to end connectivity', published on 13 September 2006, http://www.ofcom.org.uk/consult/condocs/end_to_end/statement.

³¹ See Ofcom Statement "End-to-end connectivity" published on 13 September 2006. http://www.ofcom.org.uk/consult/condocs/end_to_end/statement

³² See paragraph 3.25 "End-to-end connectivity" Statement 13 September 2006.

provided, either party may refer the matter to Ofcom to resolve under the statutory dispute resolution powers (s185 (2) of the Act).

3.45 The position was set out by the CAT in the H3G judgment:

“[End-to-end connectivity] is an obligation with some room for manoeuvre on negotiation, because the terms are to be reasonable and ultimately any dispute will be settled by someone else (the regulator). It is an obligation in those terms which has to be considered in the context of an assessment of CBP. To look just at the obligation is not to consider the true facts of the case.”

3.46 Now we turn to assess CBP by reference to all the relevant factors.

Background

BT’s position as provider of transit services

3.47 MNOs are not able to identify in all cases, on a call by call basis, from which operator a call originates. This is because BT transits a significant amount of traffic to MNOs on behalf of a number of different originating operators. Cable & Wireless also transits a limited amount of traffic to MNOs. Ofcom estimates (based on confidential information from MNOs and FNOs collected during the consultation) that of all calls to mobiles, about 43% is transited by BT and Cable and Wireless on behalf of other originating operators (34% on behalf of other FNOs and 66% on behalf of MNOs originating calls to other MNOs). BT carries $\frac{1}{3}$ and Cable & Wireless $\frac{1}{3}$ of this transited traffic. The remaining 57% of calls to mobiles is directly conveyed to MNOs, 29% by FNOs (of which BT accounts for $\frac{1}{3}$ and Cable & Wireless $\frac{1}{3}$) and 28% by MNOs. Calls transited by BT (and Cable and Wireless) appear to a MNO as if they had been originated by BT (or Cable and Wireless) when in fact they may have originated from a wide variety of different operators. The figure below sets out the share of total MCT minutes purchased by BT and other purchasers, after transit arrangements have been taken into account. The figure therefore sets out the shares of the direct purchasers of MCT.

Figure 3.1 Share of total MCT minutes purchased by different operators

Purchasing operator	Share of total MCT minutes purchased (including minutes purchased to offer transit and termination to others)
BT	$\frac{1}{3}$
Cable & Wireless	$\frac{1}{3}$
Other FNOs	$\frac{1}{3}$
MNOs	$\frac{1}{3}$
<i>Orange</i>	$\frac{1}{3}$
<i>Vodafone</i>	$\frac{1}{3}$
<i>T-Mobile</i>	$\frac{1}{3}$

O2	✂
H3G	✂

Source: Information from operators and Ofcom analysis

3.48 The figure above shows that BT is the largest purchaser of MCT with other purchasers accounting for significantly lower shares. In offering transit services BT provides other originating operators with the options to either:

- directly interconnect with a terminating MNO and negotiate an interconnection charge directly, or
- indirectly interconnect, transiting its traffic via BT and effectively allowing BT to negotiate on its behalf alongside all other originating operators who transit traffic via BT.

3.49 This provides originating MNOs with a commercial trade-off, between the two options. The option that is best depends on

- the termination charge BT agrees with the terminating MNO and BT's charge for transit, compared to
- the termination charge the originating operator agrees with the terminating MNO and the costs associated with establishing direct interconnection.

3.50 The MCT charge that BT agrees to with each MNO (plus transit charge) therefore acts as a ceiling to the MCT charge that other originating operators would be willing to accept from a terminating MNO. If a MNO sought to charge an originating operator a higher charge than the charge BT has secured with that MNO the originating MNO would have the option to transit its traffic via BT rather than directly interconnect. In practice there is no compelling evidence of originating operators seeking to transit traffic via BT for this reason. However, this may be because MNOs have always charged the same MCT charge to all originating operators.

3.51 Moreover, the MCT charge that BT agrees with each MNO may also act as a floor on the MCT charge that the terminating MNO will agree to with other originating operators. If an originating operator sought to secure a lower MCT charge with an MNO than the one BT had secured with that MNO, the MNO can refuse direct interconnection and force the originating operator to transit traffic via BT. This ensures that the originating operator pays the same termination charge as BT. For this to be the case the originating operator must be unwilling to accept a situation in which it does not interconnect with the MNO.

3.52 Therefore Ofcom considers that BT's charge (as a transit operator) conditions negotiations and effectively sets the charge for all other agreements between suppliers and purchasers of MCT. Even if this were not the case, the fact that BT is by far the largest purchaser of MCT means that if it were found not to have a level of CBP sufficient to negate any prima facie finding of SMP, it would follow that neither would any other purchaser of MCT.

Review of evidence - Negotiation of charge changes

3.53 As stated in the H3G reassessment consultation, Ofcom has considered information relevant to the discussions and negotiations between BT and H3G, regarding H3G's

voice call termination charges. Annex 1 sets out that information. The information is included in an annex for ease of reading, since this information is historic but is incorporated by reference in to this decision.

- 3.54 Annex 2 to this document contains confidential information on developments between H3G and BT that have recently taken place in respect of H3G's mobile voice call termination rate. This information includes reference to the recent dispute between H3G and BT as to H3G's termination charges. Ofcom will consider any relevant information supplied as part of resolving this dispute.

Section 4

Assessment of the existence and extent of BT's CBP

- 4.1 For the reasons explained previously, in this section, we consider whether BT has a degree of CBP in relation to its purchase of wholesale call termination from H3G sufficient to prevent H3G from being able to behave to an appreciable extent independently of competitors, customers and ultimately consumers.
- 4.2 The structure of this section is as follows:
- 4.3 First, at paragraphs 4.17 to 4.74, Ofcom considers further the evidence in assessing CBP, namely, whether and to what extent BT:
- a) represents an important outlet for H3G;
 - b) is well informed and price sensitive;
 - c) is able to exert bargaining strength by reason of reciprocity of trade;
 - d) is able to draw on alternative sources of supply; or
 - e) has the option not to purchase or to delay purchase.
- 4.4 Second, at paragraphs 4.75 to 4.81, Ofcom reviews and responds to evidence with regard to the economic framework submitted to it on behalf of H3G.
- 4.5 Finally, at paragraphs 4.82 to 4.84, Ofcom sets out its conclusion that neither BT nor any other purchaser of MCT has sufficient CBP to constrain the MNOs' SMP in the relevant markets for wholesale mobile voice call termination.

Assessment of CBP

Introduction

- 4.6 The CAT in its H3G Judgment notes that CBP is not a binary issue:

“...CBP is the power of counterparties to offset the powers of the party whose allegedly superior powers are under consideration, and the important question is what degree of CBP is there, and (bearing in mind all the circumstances) does it operate to a sufficient extent so as to mean that there is no SMP? CBP is not an absolute concept in terms of its strength. It is a concept which embodies a possible range of strengths. In any case where it is relevant, the relevant question is likely to be not whether there is CBP or not, but whether there is any CBP, and if so how much and what effect does it have.”³³

³³ Paragraph 110c of the judgment.

- 4.7 The OFT has also set out relevant guidance,³⁴ which states that the strength of buyers and the structure of the buyers' side of the market may constrain the market power of a seller. The OFT Guidance notes that the relevant consideration in assessing the impact of buyer power on the ability of the seller to set a price is whether a buyer would have choice, or, in other words, the benefit of an 'outside option'.
- 4.8 The OFT Guidance notes that the analysis of buyer power requires an understanding of the way that buyers interact with suppliers. Buyer power can be thought of as the degree of bargaining strength in negotiations. Analysis of buyer power normally becomes relevant only where there are a few relatively important buyers in terms of share of supply as opposed to a large number of buyers who are price takers. The OFT sets out a number of conditions which might imply that an undertaking's bargaining power could be of sufficient strength:
- “the buyer is well informed about alternative sources of supply and could readily, and at little cost to itself, switch substantial purchases from one supplier to another while continuing to meet its needs;
- the buyer could commence production of the item itself or 'sponsor' new entry by another supplier (e.g. through a long-term contract) relatively quickly and without incurring substantial sunk costs;
- the buyer is an important outlet for the seller (i.e. the seller would be willing to cede better terms to the buyer in order to retain the opportunity to sell to that buyer);
- the buyer can intensify competition among suppliers through establishing a procurement auction or purchasing through a competitive tender (see Part 4)...”³⁵
- 4.9 A further criterion is considered by the ERG, namely factors determining whether the buyer is price sensitive.³⁶
- “The higher the portion of the costs for a service in relation to their total expenditure and the better informed, the more sensitive consumers are as to the price and quality of the service and the more ready they might be to switch suppliers or to reduce demand.”³⁷
- 4.10 Finally, in the context of wholesale mobile voice call termination, there is a further relevant factor, namely whether or not reciprocity exists in negotiations between parties. This criterion will be addressed in paragraph 4.36 – 4.38 below.
- 4.11 Below, we consider the relevant criteria for assessing CBP and apply them to the facts as between H3G and BT; namely, whether and to what extent BT:

³⁴ Assessment of market power, understanding competition law, OFT, 2004.

(See <http://www.of.gov.uk/NR/ronlyres/A92F91BC-B556-4724-8D2B-7002F6CDEA65/0/oft415.pdf>)

³⁵ Ibid. page 24

³⁶ “Revised ERG Working paper on the SMP concept for the new regulatory framework”, October 2004, (See http://www.erg.eu.int/doc/publications/public_hearing_concept_smp/erg0309rev1_smp_working_doc.pdf)

³⁷ Ibid. paragraph 11

- a) represents an important outlet for H3G;
- b) is well informed and price sensitive;
- c) is able to exert bargaining strength by reason of reciprocity of trade;
- d) is able to draw on alternative sources of supply; or
- e) has the option not to purchase or to delay purchase.

Description of the bargaining situation between H3G and BT with respect to mobile voice call termination

- 4.12 The framework within which Ofcom has conducted the CBP analysis is the same as the one proposed by H3G,³⁸ namely a bilateral monopoly setting, with H3G as the monopolist (only 1 seller) and BT as the monopsonist (only 1 buyer) of termination. This is a widely used and recognised framework for characterising negotiations of fixed-to-mobile termination and is the framework that was used in the June 2004 CTM statement. Ofcom's review of the evidence confirms that it remains appropriate.
- 4.13 Two papers, one written by D. Harbord and K. Binmore³⁹ and one by D. Harbord⁴⁰ have been submitted by H3G with respect to their views on CBP. The first paper contains a generic analysis of CBP as a constraint on monopoly power and describes as a bilateral monopoly the negotiations between an incumbent fixed network operator and a new entrant providing mobile voice call termination. The second paper, presented to the CAT during the course of the proceedings, contains an application of this model setting out H3G's views on its negotiation with BT.
- 4.14 In paragraphs 4.75 to 4.81 below, the results obtained by Harbord and Binmore are discussed with reference to the assumptions used in their model. Ofcom explains why it considers the characteristics of the bargaining situation between H3G and BT to be different from the assumptions used by Harbord and Binmore and why therefore, whilst using the same framework, Ofcom reaches a different conclusion.

Assessment of BT's CBP

- 4.15 This section assesses for the period 1 June 2004 to 31 March 2007 the extent to which BT may exert sufficient CBP so that prices charged by H3G for MCT are constrained to the competitive level.
- 4.16 In assessing BT's CBP Ofcom has taking into account both responses it has received to the H3G reassessment consultation, as well as the responses to the September 2006 CTM review consultation in so far Ofcom considers that they are relevant also to the period 1 June 2004 to 31 March 2007.

³⁸ In its cover letter responding to Ofcom's Section 135 information request, dated 7 February 2006, H3G refer to the paper by Binmore and Harbord, published in the Journal of Competition Law & Economics, 2005.

³⁹ 'Bargaining over Fixed-to-Mobile Termination Rates: Countervailing Buyer Power as a Constraint on Monopoly Power', published in the Journal of Competition Law & Economics, 2005.

⁴⁰ 'Ofcom's finding of SMP by H3G in setting wholesale mobile voice call termination rates', A report to the Competition Appeal Tribunal dated 28 July 2004.

Assessment of BT's CBP - BT as an important outlet for the seller

- 4.17 As explained in section 3 above, being an important customer may confer a degree of CBP on the buyer. This is because the seller will be more willing to negotiate with a customer it cannot afford to lose.
- 4.18 BT is, and at all times has been, an important customer for H3G. Ofcom estimated in the September 2006 CTM review consultation that BT purchases around 60% of all UK off-net termination on mobile networks. This is because BT buys termination for its own subscribers originating calls on its networks and also acts as a transit operator for other FNOs and MNOs. As a consequence, prior to launch it was necessary for H3G to reach an agreement with BT as prospective subscribers to the H3G network would see relatively little value in joining a network which precluded making calls to and receiving calls from and through customers connected to BT.
- 4.19 H3G's customer base has grown substantially over time. According to a press release on H3G's own website, dated 10 May 2006, H3G reports that its current registered subscriber base is over 3.5 million subscribers, \times , whereas in March 2004 its customer base was estimated to be between 384,300 and 420,000.⁴¹ However, by comparison, BT has always had a significantly larger subscriber base than H3G (currently approximately 28m subscriber lines), and BT remains a key buyer for H3G's services.
- 4.20 Two trends are likely to affect H3G's position in the future, namely the growth of its own network (which will lead to an increase in the proportion of on-net calls and will also increase the cost to BT of not purchasing MCT from H3G⁴²) and any trend towards direct interconnection which would reduce the need to use BT as a transit operator.
- 4.21 H3G's growth in customers has led to a corresponding increase in H3G's share of on-net traffic as a percentage of H3G's total terminating traffic, from \approx in Q1 2004 to \approx in Q3 2005. This means that, although BT is still an important customer, H3G's share of incoming traffic originated outside its own network as a percentage of its total traffic is decreasing and hence the importance of other operators and especially BT is declining.
- 4.22 H3G to date has had a national roaming agreement with O2, but following a tender process has now also entered into a roaming agreement with Orange who will now also provide national roaming to H3G. Because of the national roaming agreement, O2 interconnected directly with H3G. We believe the direct interconnection between H3G and O2 will stay in place. On the basis that the interconnection agreement between O2 and H3G remains in place, one additional MNO will now interconnect directly with H3G; this is likely to result in a decrease of transit traffic via BT.
- 4.23 Except for BT, no other fixed operator interconnects directly with H3G. The other FNOs all use BT to transit calls bound for H3G subscribers.
- 4.24 There is a commercial trade-off associated between the choice to directly interconnect or to use a transit service for termination. The outcome of this trade-off depends on the relative costs of each approach, namely:
- The termination charge BT agrees with the terminating MNO;

⁴¹ See June 2004 Statement, paragraph 5.29.

⁴² Regarding the latter see paragraph 4.43-4.47 below.

- BT's charge for transit;
 - The termination charge the originating operator agrees with the terminating MNO; and
 - The costs associated with establishing direct interconnection.
- 4.25 The result of originating operators having these two options is that BT's charge for transit to a given MNO sets a ceiling for the termination charge an originating operator would agree to with the same MNO. If the charge it agrees is too high compared to the cost for transit via BT it will be more economic to transit its traffic via BT rather than directly interconnect. Therefore the strength of BT's bargaining position is very important as it sets a ceiling for the price other originating operators (both fixed and mobile) would be willing to accept for wholesale termination.
- 4.26 As regards the recent evidence from Ofcom's information requests from the parties (referred to in Annex 2 to this document), Ofcom notes that the timing of the recent proposals to vary MCT charges means that it is very difficult to determine to what extent the behaviour of the parties and the response of purchasers to the proposals, may be considered significant in the context of an assessment of whether suppliers have SMP and whether any purchasers have CBP. However, in Ofcom's view, the timing of the recent proposals to vary MCT charges makes it very difficult to determine to what extent the behaviour of the parties (suppliers and purchasers) has been affected by awareness of the significance which might be read into such behaviour.
- 4.27 For H3G, having BT as an outlet was of fundamental importance at the time of H3G's launch. It is noted that this is increasingly counter-balanced by the fact that - as H3G's subscriber base grows - terminating calls on H3G's network is also becoming increasingly important to BT, since a higher share of BT's outgoing calls will terminate on H3G's network. Further, as H3G will enter into more direct interconnection contracts with other operators, BT's share of H3G's voice call termination minutes, and hence its importance as an outlet, will be reduced. However, taking into account the size of BT's customer base, we consider BT remains an important customer for H3G for the period until the end of March 2007.

Assessment of BT's CBP - BT as a well-informed and price sensitive buyer

- 4.28 It may reasonably be assumed that BT is a price sensitive and well informed buyer with extensive commercial expertise. Over time, BT has established a large number of interconnection contracts with both fixed and mobile operators and has built up a vast amount of experience in terms of negotiating terms and conditions of interconnection contracts. It is well informed in that it knows the prices it has established with other operators, and the impact of termination prices on its own business plan assumptions in respect of prices and volumes of fixed calls to mobile.
- 4.29 Whilst, during the start-up phase of its business, H3G was likely to only make up a very small proportion of BT's total expenditure on mobile termination, this has changed over time as H3G's subscriber base has grown. As termination on H3G's network represents an increasing cost to BT, BT is likely to become increasingly sensitive to the price it pays for that service.
- 4.30 Further, since mobile voice call termination on 2G and 3G networks is essentially the same service from an end user's perspective (end users will in general not be aware

whether a voice call will be terminated on a 2G or a 3G network), it appears reasonable that BT would:

- compare the charge with that offered by other providers of mobile call termination, i.e., the other MNOs, for a similar service; and
- recognise the implications of the retail prices faced by its subscribers for calls to different mobile networks.

4.31 The evidence shows that both of these factors were taken into account by BT. For example, in an e-mail from BT to H3G, BT sets out that “it has reached the conclusion that proposed termination rates, being significantly higher than call charges to other existing GSM services, represent too high a cost for BT’s retail customers”.⁴³

4.32 H3G’s importance as a customer to BT has increased over the period given the growth in H3G’s customer base:

- There is a material volume of incoming traffic from H3G subscribers to BT subscribers; and
- It is important to BT’s subscribers that they are able to contact H3G’s increasingly significant subscriber base.

4.33 Therefore, in June 2004, and increasingly so as H3G has grown, BT is and will be well-informed and price sensitive in respect of H3G’s mobile voice call termination charges. It has had and will continue to have an incentive to negotiate prices with H3G. However, as H3G has become a more important supplier, BT’s bargaining power in its negotiations is likely to be reduced.

4.34 As such, Ofcom considers BT is a well informed and price sensitive buyer.

4.35 Knowledge and price sensitivity alone are insufficient to constrain prices though given that H3G is the only supplier, BT’s influence on the prices H3G can charge depends on whether BT can exercise credible threats to force prices down. Initially, delay was a relevant factor in this due to the impact a delay might have on H3G’s launch date. Also, the cost of not purchasing termination is potentially higher to H3G than to BT. These issues are considered in the following sections below:

- The ability and incentives for one party to threaten to boycott the other party temporarily and stop purchasing call termination; and
- The ability and incentives for one party to delay an agreement with the other party.
- Assessment of BT’s CBP - Reciprocity of trade between the BT and H3G

4.36 The extent of BT’s buyer power will be influenced by the extent to which it can include the prices it charges for its own services as part of the negotiations. For example, BT, with a market share of around 75% of fixed lines by volume, might potentially be able to exert significant bargaining power in respect of H3G’s price for wholesale mobile voice call termination by including the price it charges for fixed termination as part of the negotiations.

⁴³ Email from BT to H3G dated 3 December 2001.

- 4.37 However, as set out above, BT's termination rate is determined by regulation. This regulation exists independently of a finding of SMP on H3G supplying MCT and therefore, as discussed above, should be taken into account. As a consequence, the price BT charges H3G for termination on BT's network cannot influence the negotiations of the price H3G charges BT for MCT on its network and cannot therefore be considered to be a source of BT's bargaining strength.
- 4.38 Where BT sells other services to H3G, for instance leased lines, it might be able to use the terms on which they sell those services in the negotiation the mobile call termination rate with H3G. However, no evidence has been submitted by either party that suggests BT has considered or tried to leverage the sale of other services in its purchase of wholesale mobile voice call termination services from H3G and in any case its scope to do so may also be limited by regulation of its charges for certain wholesale and retail lease line products.
- Ofcom considers that this constraint on reciprocal bargaining removes from BT a key bargaining counter.

Assessment of BT's CBP – BT's lack of alternative sources of supply

- 4.39 The ERG explains that in order to constrain the seller's price effectively, the purchaser must be able to bring some pressure to bear on the supplier to prevent a price rise:
- “...The extent of countervailing buyer power largely depends on whether customers can credibly threaten to switch to other suppliers, to self-provide the service, to significantly reduce consumption or to cease to use the service at all in case of a price increase...”⁴⁴
- 4.40 Where the buyer may be able to induce competition between sellers, for example via a procurement auction, the buyer can be expected to have considerable power to determine the terms of trade.
- 4.41 A further consideration is the extent to which the buyer is able to self-provide the good or service in question. If so, this would present the buyer with an alternative to purchasing from the prospective seller, thereby presenting the buyer with a bargaining mechanism.
- 4.42 Since the relevant market is the market for wholesale mobile voice call termination on H3G's network, and H3G has a market share of 100% on this market, it is only H3G that can terminate calls on its own network. Therefore, competitive entry by an alternative supplier cannot be expected; there are absolute barriers to entry. BT can neither seek to enhance its bargaining position by relying on competition between sellers nor can it opt to self-supply.
- Ofcom considers that BT cannot seek to enhance its bargaining position by relying on competition between sellers. Nor can it opt to self-supply.

⁴⁴ See paragraph 11 “Revised ERG Working paper on the SMP concept for the new regulatory framework”, October 2004, See http://www.erg.eu.int/doc/publications/public_hearing_concept_smp/erg0309rev1_smp_working_doc.pdf.

Assessment of BT's CBP – BT's option not to purchase

- 4.43 Absent other potential sources of supply (i.e. third party or self-supply), a buyer may bring pressure to bear on the seller in the event that it can threaten credibly not to purchase the service (or, to a lesser extent, to threaten to reduce the amount it purchases). This source of negotiating strength is not based on the buyers' capability to substitute the service - even if at some cost - for a similar service but, rather, on the relative importance to the buyer and the seller, respectively, of reaching a deal and specifically the ability of the buyer to credibly threaten not to purchase. In the context of the establishment of an initial agreement between the buyer and seller, a further relevant consideration is the extent to which the buyer can threaten credibly to delay.
- 4.44 As discussed at paragraphs 4.17-4.24 above, having BT as an outlet was of fundamental importance at the time of H3G's launch. While BT still is an important customer of H3G, it was also noted that this is today counterbalanced by H3G's growing size as a network and by the prospect of further direct interconnection in future. It is therefore relevant to assess the extent to which a threat to refuse to continue purchasing MCT would provide BT with buyer power such that it could influence in its favour the price charged by H3G for MCT. In this respect Ofcom has identified two issues:
- Commercial constraints; and
 - BT's end-to-end connectivity obligation.
- 4.45 From a commercial perspective, the credibility of a threat to cease purchasing is related to how important it is for an originating operator to provide calls for its subscribers to the subscribers of a particular mobile network. It is also related to how important it is for the terminating MNO to offer its customers the ability to receive calls from the originating operator in question.
- 4.46 In the case of BT, its obligation to provide end-to-end connectivity is also a relevant consideration. BT's end-to-end connectivity obligation requires BT to purchase termination from each of the MNOs. If the obligation on BT to purchase termination were absolute, BT would not have any buyer power at all. However, as noted by the CAT the obligation on BT is not an absolute one; the request to purchase must be reasonable. If BT does not consider a request is reasonable, it can bring a dispute to Ofcom, to determine whether the request is reasonable and whether, consequently, BT has an obligation to purchase at that price. This is considered further at paragraphs 4.56 to 4.74 below.

Assessment of BT's CBP - Option to delay

- 4.47 In principle, BT might threaten to delay its purchase of termination from H3G and thereby improve its negotiation position against H3G. Indeed, in a setting where both parties to a transaction do not have the choice of walking away from a deal indefinitely, the parties may try to obtain a more favourable outcome by threatening to delay the transaction.
- 4.48 A strategy like this may have been effective prior to the negotiation of the initial agreement in January 2002, when BT may have been able to exploit H3G's sensitivity to a delay in interconnection. The evidence from the period shows that

H3G was concerned about the potential impact of delay on its launch.⁴⁵ While, as the CAT recognised, it does not appear that BT aggressively sought to exploit the risks of delay to H3G,⁴⁶ it is possible that this factor may, at that time, have affected the overall balance of negotiating power between the parties.

- 4.49 Following the conclusion of the agreement in January 2002, delay is unlikely to be a factor in any new negotiation relating to price since there no longer is significant asymmetry between the parties in respect of their sensitivity to delay. An OCCN can be issued by either party to propose a change in tariff. If either party were to delay agreement to an OCCN, all that would be lost or gained would be the value of the difference between the existing and the proposed price. Ultimately, the most likely outcome of a disagreement and stalemate regarding termination charges between H3G and BT would not be a delay of the purchase of services, but a referral of a dispute to Ofcom. In paragraphs 4.56 to 4.74 below, Ofcom has set out how it might seek to resolve such a dispute between H3G and BT in the context of end-to-end connectivity if it was brought to it.
- 4.50 Although BT could, in principle, seek to draw out any negotiations of an OCCN, in particular if the OCCN were issued by H3G and aimed to raise the termination charge, it is unlikely that this threat would be effective in improving its bargaining position as it would no longer be matched by time-pressure on H3G's side.

Commercial constraints

- 4.51 As noted above, the evidence on the negotiations between BT and H3G for the initial agreement suggested that there were – even at a time when H3G was a new entrant - commercial incentives for BT to provide their subscribers with the opportunity to call H3G. In particular, Ofcom notes that the evidence considered at paragraphs 3.47-3.52 above suggests that BT - as the largest purchaser of MCT - regarded the entry of H3G (then a very small new entrant) in 2001 as an opportunity for incremental income from its retail customers rather than a potential threat to its own access and origination revenue.⁴⁷ BT itself therefore judged that it had a commercial incentive to purchase call termination services from H3G.
- 4.52 Furthermore, as BT noted in its response to the September 2006 CTM review consultation BT's wholesale obligation to offer CPS and IA would mean that, in the event that BT ceases to purchase MCT from one or more MNO (and, therefore, is unable to continue offering its retail customers calls to those MNOs) it would be exposed to the risk that CPS and IA operators would offer BT's retail customers alternative means to call mobiles (and, in addition, the means to call other number ranges). Ofcom notes in this context that BT has been obliged to provide CPS and IA throughout the period of this review (2004-2007). However, how fast alternative providers (including those with their own local network infrastructure) could at any point in time offer calls to mobiles without continuing reliance on BT transit services, would depend on how quickly they could either establish direct interconnection with MNOs and how quickly C&W (which already provides transit) and others could offer additional transit capacity. Similarly, BT would also face a material risk that, in the

⁴⁵ For example in an internal H3G memo dated 15 October 2001, attached to an email dated 12 October 2001, which notes the "time critical" nature of the BT agreement and subsequent memos relating to BT's rejection of Hutchison3G's interim call termination rate, which cites the risk of "impact on launch dates".

⁴⁶ See the CAT's judgment, paragraph 81.

⁴⁷ WPAG paper "Proposed termination rates for calls to H3G's mobile services", Internal BT paper dated 10 January 2002.

absence of the ability to call mobiles from BT fixed lines, customers would resort to using mobile originated calls (notwithstanding that the price differential, in the case of a small non transitory increase in price, would normally mean that mobile originated calls to mobiles are not a substitute for fixed originated calls to mobiles).

- 4.53 Furthermore, BT also noted that even if BT could choose to walk away from purchasing mobile termination from a particular operator, the effectiveness of such a strategy would be undermined by the existence of the number portability obligation. This would mean that when a customer ported from a donor network to a recipient network, BT would be unaware that the number was now hosted on a network to which they otherwise might not provide termination. Similarly BT would be unable to provide connection to customers who had ported from the “excluded network” because it would be unaware that they were no longer hosted on that excluded network.
- 4.54 Finally, as BT also noted in its response to the September 2006 CTM review consultation, the level of consumer dissatisfaction in the event that BT ceased to offer retail calls to one or more MNO is likely to be exacerbated by mobile number portability. It is unlikely to be practicable for originating operators to cease providing calls to the customers of a subset of MNOs without also disabling the ability to call customers who had ported their numbers from those MNOs. The impact on the reputation of an originating operator in these circumstances is likely to be high and very damaging, and may exceed the cost of paying excessive termination charges.
- 4.55 As demonstrated in the evidence before Ofcom there is no indication that BT has ever considered this as an option. To the contrary, as noted above, even though BT did consider the first offer made by H3G as high, BT appeared at all times proactive in establishing an agreement on charges. BT also appeared to employ considerable effort to consider whether it was possible to grant H3G a different charging structure from that prevailing with other MNOs.
- In Ofcom’s view, therefore, today BT faces strong commercial pressure to purchase MCT from H3G.

BT’s end-to-end connectivity obligations

- 4.56 As set out in paragraph 3.32 above, it was and always has been Ofcom’s policy to ensure end-to-end connectivity. At the time of the establishment of the initial agreement between H3G and BT, BT was under a licence condition to offer end-to-end connectivity. Therefore, at that time BT would not have been in a position to credibly threaten not to purchase H3G’s services on reasonable terms and conditions.
- 4.57 In addition to this, the evidence suggests that BT regarded the entry of H3G into the mobile market in 2001 as an opportunity for incremental income from its retail customers.⁴⁸ It therefore had an incentive to purchase call termination services from H3G.
- 4.58 From May 2003 until 7 September 2006, with the publication of the statement on end-to-end connectivity, should BT unilaterally have threatened to, or actually stopped purchasing services from H3G between May 2003 and September 2006, then H3G could have referred this issue as a dispute to Oftel/Ofcom. As H3G has

⁴⁸ WPAG paper “Proposed termination rates for calls to H3G’s mobile services”, attached to internal BT email dated 10 January 2002.

interconnection in place it was no longer sensitive to such delay. Oftel or Ofcom could have imposed an Article 5 Access obligation on BT (similar to the obligation which has been imposed on BT in the statement on end-to-end connectivity), to ensure its policy objective and mandate end-to-end connectivity.

- 4.59 Therefore, from May 2003 until September 2006, BT could not and did not threaten not to purchase H3G's services on reasonable terms and conditions.
- 4.60 From 13 September 2006 onwards, BT has an end-to-end connectivity obligation. BT is obliged under its end-to-end connectivity obligation to purchase MCT following reasonable request and on reasonable terms and conditions. After purchasing MCT, BT is not able unreasonably to change, withdraw or restrict access to an applicable Normal Telephone Number.
- 4.61 However, those obligations are not absolute. BT is required to purchase on reasonable terms and conditions. If BT and H3G were unable to agree upon terms for the supply of MCT, either party could refer the dispute about the application of the regulatory obligation on BT to Ofcom to resolve. Therefore, the extent to which any CBP that BT would otherwise possess is negated by its end-to-end connectivity obligation could depend in part on the expectations of the parties to a dispute as to Ofcom's resolution of that dispute.
- 4.62 The negotiations between BT and H3G may therefore be partly conditioned by the range of prices which those parties consider that Ofcom would be likely to regard as reasonable in applying BT's end to end connectivity obligation. The range of prices would affect BT's "freedom of manoeuvre" in negotiating the price of MCT, and should therefore be taken into account in determining whether, and to what extent, BT may have CBP.⁴⁹
- 4.63 Ofcom is currently considering a dispute as to the charges that BT pays H3G for terminating voice calls on its network, and Ofcom will not be in a position to determine this dispute prior to the publication of this Statement.⁵⁰ In the context of considering H3G's reassessment, H3G have supplied further information regarding the negotiation of its charges for mobile call termination. This covers the period after the setting of BT's End-to-End connectivity obligations. This information is set out in Annex 2 to this document.
- 4.64 In resolving a dispute relating to the application of BT's end-to-end connectivity obligation, Ofcom would consider each dispute on its merits, in the light of the specific facts and circumstances and the arguments put to it by the parties to the dispute, including the reasonableness of any resolution on both parties.
- 4.65 As explained at paragraph 5.100 of the September 2006 CTM review consultation, a number of alternative approaches would be open to Ofcom in dealing with a dispute between BT and an MNO as regards whether a price proposed for MCT is a reasonable one for the purposes of applying BT's end-to-end connectivity obligation. However, Ofcom would consider the question of what is reasonable by reference to the purpose underlying BT's end-to-end connectivity obligation. The end-to-end connectivity obligation was imposed on BT to remove the risk of a potential market failure from BT refusing to buy call termination. While in principle, BT's customers value calling customers of smaller networks and customers of smaller networks may

⁴⁹ See the judgment of the CAT in the H3G case, at paragraph 126.

⁵⁰ http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ocases/open_all/cw_942/.

value receiving such calls, BT may have an incentive not to provide such calls under some circumstances.⁵¹

- 4.66 On this basis, a reasonable charge for BT to purchase MCT with a view to ensuring end-to-end connectivity may be at a price appreciably above the competitive level. As such, if a charge appreciably above the competitive level were in dispute, Ofcom considers it unlikely that it would insist on a strictly cost based charge (ie a charge that was not appreciably above the competitive level).
- 4.67 It should be noted, however, that the fact that Ofcom had resolved a dispute about end-to-end connectivity in a particular way, would not preclude Ofcom from considering subsequently whether the charge offered (or other factors) indicates that there might be a competition problem in the market for the supply of MCT.
- 4.68 In contrast, Ofcom considers that where a dispute relating to the provision of network access for MCT is referred to it by the parties, and there is no pre-existing regulatory obligation, then the outcome of that dispute should not be taken into account in any assessment of a supplier's SMP.
- 4.69 This position is consistent with the CAT's finding in the H3G judgment, that Ofcom's role in resolving disputes under clause 13 of the interconnection agreement between BT and H3G should be disregarded when assessing H3G's market power because it amounted to regulation of H3G (at paragraph 138(b)). The CAT stated that:
- “The sort of dispute that clause 13 contemplates is a form of interconnection dispute, which OFCOM would resolve as regulator, not as a third party dispute resolver. Its intervention would therefore be as regulator, and would be a form of regulation. It therefore falls to be disregarded, as a matter of principle, just as OFCOM's general presence as a regulator with a potential effect on the conduct of the putatively regulated person falls to be disregarded, for the reasons given above.”
- 4.70 In any event, because there is no *ex ante* obligation to lend a structure to Ofcom's role, it is not possible to specify what approach Ofcom would apply in resolving a dispute. Ofcom's determination would depend on the facts of each case and the submissions made to it. A broad range of options and methodologies would be available to Ofcom.
- 4.71 Additionally, Ofcom would have to consider, as a matter of policy, whether it would be appropriate to assess the market power of the parties and impose cost-orientated charges where no such obligation previously existed because, for example, there had not yet been a market review, or there had been a market review but the dispute revealed that market circumstances had since changed.
- 4.72 In Ofcom's view, this suggests that neither party in a negotiation over MCT, where the MNO had not been found to have SMP, can assume that Ofcom (when resolving such a dispute) would impose a charge for MCT that was not appreciably above the competitive level.

⁵¹ See for example, paragraphs 2.12, of Ofcom's *End-to-end connectivity statement*, dated 13 September 2006.

- 4.73 Ofcom therefore concludes that a purchaser and supplier of MCT, properly apprised as to Ofcom's approach to dispute resolution, would therefore negotiate on the basis that if a charge appreciably above the competitive level were in dispute, Ofcom would be unlikely to impose a charge for MCT in the context of such a dispute that was not appreciably above the competitive level.
- 4.74 Further, Ofcom considers that certain limitations exist in relation to dispute resolution such that dispute resolution should not be seen as a substitute for the appropriate regulatory processes for addressing the question of market power as set out in Articles 15 and 16 of the Framework Directive. In addition, dispute resolution is of limited assistance in curbing pricing appreciably above the competitive level as it is aimed at resolving a dispute between two (or more) parties and regulators can only act in the context of that dispute - which may not address the "regulatory" issue i.e. general pricing issues. Moreover, it is only a mechanism that Ofcom can rely on when asked to do so by one or more of the parties in dispute. It is therefore not necessarily the case that: an MNO would bring a dispute; or, another provider would refuse to purchase interconnection at a charge appreciably above the competitive level.

Review of H3G's evidence with regards to the economic framework

- 4.75 As set out in paragraphs 4.13 and 4.14 above, H3G has submitted that two papers by Harbord and Binmore should form the starting point for any further analysis to be undertaken by Ofcom. These papers set out a proposed economic framework for assessing CBP. In this section, Ofcom considers the arguments presented by Harbord and Binmore in their published paper, as well as David Harbord's submission to the CAT dated 28 July 2004.
- 4.76 Binmore and Harbord state that their model predicts that incumbent fixed network operators (BT) will never agree to pay H3G a termination rate which exceeds the cost of termination, and that it is likely that charges will lie between average 2G rates and the entrants' (3G) cost (assuming that the regulated 2G rates lie below the 3G cost of termination).
- 4.77 As with every economic model, this result is based on a number of assumptions on the parties' incentives and their ability to act upon them. As explained in the following paragraphs, those assumptions are not justified by the facts of the present situation and therefore lead to erroneous conclusions.
- 4.78 Critical to the results of Binmore and Harbord's model are the assumptions as to how Ofcom would resolve a referred dispute. The assumptions underlying Binmore and Harbord's results are that the regulator would either set a charge based on the average 2G rates or would set a charge based on H3G's costs. Were these assumptions correct, Ofcom would agree that it is probable that the outcome of a negotiation would be likely to lie in this range. However, it is clear from the explanation of Ofcom's dispute resolution policy above that the assumptions made by Binmore and Harbord in respect of dispute resolution in the context of the end-to-end connectivity obligation are erroneous. As explained above, in resolving a dispute in the context of end-to-end connectivity, Ofcom has a broad range of options. Importantly, the range of potential charges set in the context of an end-to-end dispute is wide, and if a charge appreciably above the competitive level was in dispute, it would be unlikely that Ofcom would impose, in the context of such a dispute, a charge that was not appreciably above the competitive level.

- 4.79 As regards the negotiations prior to the Initial Agreement, Binmore and Harbord considered the impact that impatience on the side of the seller (e.g. because his entire future stream of profits depends on the establishment of interconnection with BT) may have on the seller's bargaining position, concluding that it would weaken it considerably. From the evidence before it, Ofcom considers that H3G did perceive the cost of delay prior to the establishment of the Initial Agreement to be significant since delay represented an opportunity cost to H3G through foregone income. Whilst Ofcom has seen no compelling evidence that may suggest that BT artificially delayed establishing the Initial Agreement, it is possible that the fact that H3G was under pressure to conclude the initial negotiations on charges presented BT with a stronger bargaining position prior to the initial agreement.
- 4.80 However, the relative bargaining positions of the two parties – and hence the likely outcome of the analysis – changed significantly once an Initial Agreement had been reached and both parties had a sizeable customer base. In particular, once the initial termination agreement and charges were in place, there was no longer significant asymmetry in the cost of delay between the parties. Indeed, this change in situation is recognised by H3G in a letter to Ofcom after the establishment of the initial agreement where H3G informed Ofcom that it was hopeful that a reasonable commercial solution could be reached.
- 4.81 In summary, Harbord and Binmore reached their conclusions based on erroneous assumptions about what Ofcom would do in the event of a dispute. Harbord and Binmore erroneously assume that the best assumption about the outcome of such a process is that it would yield charges at cost or at the level of charges of the 2G operators. However, as Ofcom explain above, this is unlikely to be the case absent a finding of SMP on H3G. As a consequence, Ofcom does not find Harbord and Binmore's arguments persuasive: their assumptions do not accord with the characteristics of the case and therefore their conclusion that dispute resolution constrains H3G to charge no more than cost is flawed.

Conclusion on CBP

- 4.82 In light of the factors explored above, it is Ofcom's view that BT does not have sufficient CBP to constrain H3G's ability to behave to an appreciable extent independently of competitors, customers and ultimately consumers, such that H3G is unable to sustain charges appreciably above the competitive level.
- 4.83 H3G has a 100% market share in the market for wholesale mobile voice call termination on its own network, and there are absolute barriers to entry to that market.
- 4.84 Over the period from 1 June 2004 to 31 March 2007, while BT was an important outlet for H3G and a well informed and price sensitive buyer, the absence of reciprocity in negotiations between BT and H3G meant that BT had significantly less CBP than would be the case in the presence of reciprocity. Moreover, there were no alternative sources of supply and BT was unable to self supply. BT also faced a strong commercial incentive to purchase MCT (heightened by its CPS and IA obligations). BT is subject to an end-to-end connectivity obligation, and in Ofcom's view, this means that BT has insufficient CBP to negate MNOs' SMP, even taking into account that it is not an unbounded obligation on BT and that disputes (where relevant) can be referred to Ofcom for resolution.

Section 5

Other relevant SMP criteria and developments

Introduction

5.1 As set out in Section 2.23 above, the CAT's order required Ofcom to:

- Reconsider whether H3G has SMP in the market for mobile wholesale voice termination on H3G's network taking into account the extent to which CBP exists in BT and any other matters as are relevant at the time of Ofcom's reconsideration; and
- Take account of the CAT's judgment in its reconsideration.

5.2 In the preceding paragraphs we have set out what the CAT required us to do in terms of the assessment of BT's CBP. Similar to the H3G reassessment consultation, in this section we will cover the other relevant matters, starting off with other relevant SMP factors and any other factors we consider to be relevant to this assessment. None of the respondents made any comments in respect of our assessment of these factors in response to the H3G reassessment consultation.

SMP Criteria

5.3 The Commission has issued Guidelines on market analysis and the assessment of SMP (the 'Commission's Guidelines')⁵², and Oftel⁵³ and the European Regulators Group (ERG)⁵⁴ produced additional guidelines on the criteria to assess effective competition.

5.4 The September 2006 CTM review consultation considered which of the SMP factors are relevant on a forward looking basis and proposed that the same factors are relevant as in the June 2004 CTM statement.

5.5 The June 2004 CTM statement and September 2006 CTM review consultation⁵⁵ considered the following relevant factors in assessing SMP in respect of the market for wholesale mobile voice call termination on MNOs' networks:

- Market shares;

⁵² "Commission Guidelines on market analysis and assessment of significant market power under the Community regulatory framework for electronic communications networks and services" (See http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/c_165/c_16520020711en00060031.pdf.)

⁵³ Oftel's market review guidelines; criteria for the assessment of significant market power published August 2002 (See http://www.ofcom.org.uk/static/archive/oftel/publications/about_oftel/2002/smpg0802.htm.)

⁵⁴ "Revised ERG Working paper on the SMP concept for the new regulatory framework", October 2004 (See http://erg.eu.int/doc/publications/public_hearing_concept_smp/erg0309rev1_smp_working_doc.pdf#search=%22Revised%20ERG%20Working%20paper%20on%20the%20SMP%20concept%20for%20the%20new%20regulatory%20framework%22.)

⁵⁵ See consultation document 'Mobile Call Termination', section 4.14, published 13 September 2006.

- Absence of potential competition, the ease of market entry and the related criteria concerning the control of infrastructure not easily duplicated;
 - Absence of countervailing buying power and the related criteria concerning the overall and costs and barriers to switching; and
 - Excessive pricing and profitability (in the June 2004 CTM statement only).
- 5.6 In the June 2004 CTM statement, excessive pricing and profitability was only used in relation to the SMP findings on the 2G MNOs and not in relation to H3G. At the time of the June 2004 CTM statement, no accurate cost information was available against which to assess the level of H3G's prices and hence to determine whether they were excessive.
- 5.7 In the case of 3G mobile termination, the cost modelling, as set out in the September 2006 CTM review consultation, indicates that the 3G charges presently levied by H3G are significantly above Ofcom's proposed view of the appropriate charges for mobile call termination. While Ofcom in this document does not rely on this criterion for the re-assessment of H3G's SMP, it is consistent with our proposed conclusion.
- 5.8 As explained at paragraph 2.26 above, Ofcom has proceeded on the basis that:
- the definition of the relevant market, wholesale mobile voice call termination on H3G's network, continues to hold to 31st March 2007;
 - H3G has a 100% market share on that market, both when measured by volume of calls and by revenues; and
 - there are absolute barriers to entry on that market and therefore no effective potential competition.
- 5.9 Ofcom has considered below whether developments in respect of other relevant factors might affect the conclusion that H3G holds SMP.

Absence of potential competition

- 5.10 In the mobile wholesale voice call termination market, the infrastructure that would be required to allow any other provider the possibility of offering termination on H3G's network is not available. The H3G reassessment consultation reiterates Ofcom's assessment in its June 2004 CTM statement in this respect. In the June 2004 CTM statement,⁵⁶ Ofcom noted that at any time each mobile phone is generally within the coverage area of 4 or 5 different mobile networks, such that, in theory it might be technically possible to choose which network terminates the call. However, Ofcom also pointed out that this would require substantial technical changes.
- 5.11 Primarily, the ability to choose a network to terminate a call would require a common home location register (HLR) to which the MNOs could connect to via visiting location registers (VLR). Each mobile phone would only require a single SIM which would roam across networks in a similar way to international roaming. However, any implementation of a common HLR would take time, be expensive, and would probably face significant resistance from the MNOs. This generates an absolute barrier to entry in the period under consideration.

⁵⁶ See http://www.ofcom.org.uk/consult/condocs/mobile_call_termination/wmvct/wmvct.pdf.

- 5.12 Furthermore, it would still be up to the receiving party to select the cheapest terminating network, and there is no clear incentive for him/her to do so. To be successful, there are a number of criteria, including a high level of price transparency, required to enable both the calling and receiving parties to identify the various prices at both the retail and wholesale level.
- 5.13 Moreover, no technological means of terminating a call elsewhere seems likely to become available and commercially viable in the near future. Ofcom does not foresee developments that will allow another provider to compete effectively to offer termination to H3G's subscribers, other than H3G itself.
- 5.14 Therefore potential competitive entry does not provide a countervailing incentive that would constrain H3G.
- 5.15 Ofcom considers the other SMP criteria, as described in Section 4 of its September 2006 CTM review consultation⁵⁷ to be of less relevance, for the same reasons as mentioned in that consultation.

Other Developments

Mobile Number Portability and H3G's domestic roaming agreement with O2

- 5.16 As part of the responses to the September 2006 CTM review consultation, Ofcom received representations relating to the impact of indirect routing for mobile number portability on the effective termination charge (i.e. its average termination charge, taking into account revenue from termination on ported numbers). In particular it was claimed that the effect of the number portability charging arrangements curbs pricing freedom.
- 5.17 The current MNP arrangements, as described at Annex E of the June 2004 CTM statement,⁵⁸ result in the recipient operator (to whom the subscriber is porting their number) receiving the termination charge set by the 'donor' operator (from whom the subscriber is porting their number). This arises due to the existing technical arrangements for MNP whereby calls are routed to the number block allocated to each operator which then, if a call has been ported, transmits the call to the recipient operator, and retains a transit fee for so doing.
- 5.18 Ofcom recognises the impact of existing MNP arrangements on operators ability to set prices, i.e. that MNOs, including H3G, do not set call termination rates for 'ported in' subscribers. However, Ofcom concluded in the June 2004 CTM statement and in the September 2006 CTM review consultation that "the presence of ported numbers will not preclude MNOs from setting excessive termination charges to those subscribers that have not ported their number[s]"⁵⁹ and "that porting has no impact on SMP in these markets as these arrangements do not constrain MNOs' ability to set MCT charges in respect of non-ported numbers."⁶⁰
- 5.19 However, Ofcom today is also publishing a consultation "*Amendment to charge control on Mobile Network operators*" setting out proposed modifications to those charge controls.

⁵⁷ http://www.ofcom.org.uk/consult/condocs/mobile_call_term/

⁵⁸ See http://www.ofcom.org.uk/consult/condocs/mobile_call_termination/wmvct/annexe/.

⁵⁹ See http://www.ofcom.org.uk/consult/condocs/mobile_call_termination/wmvct/wmvct.pdf, paragraph 3.48.

⁶⁰ See consultation document 'Mobile Call Termination', paragraph 4.17, published 13 September.

- 5.20 H3G's income from termination is also affected by its domestic roaming agreement with O2 and/or Orange. These agreements provide that H3G subscribers can make and receive calls over O2's / Orange's network where O2's / Orange's network provides coverage but H3G's does not. ✕.
- 5.21 Ofcom notes the existence and impact of this national roaming agreement but has not relied on this in assessing H3G's SMP.

Conclusions in respect of other relevant SMP criteria and other developments

- 5.22 Ofcom considers that H3G holds a 100% market share in the relevant market, where there are absolute barriers to entry.
- 5.23 In Section 4, Ofcom considered that the level of CBP held by BT is unlikely to be sufficient to overturn the presumption of SMP flowing from H3G's 100% market share and the absolute barriers to entry.
- 5.24 Ofcom also considers that none of the other relevant SMP criteria or other developments overturn the presumption of SMP, which H3G's market share and the barriers to entry to that market would otherwise suggest. Ofcom therefore concludes that H3G has SMP in the market for wholesale mobile voice call termination on its own network.
- 5.25 Taking all of these factors together, Ofcom concludes that H3G has SMP in the market for wholesale mobile voice call termination on its own network over the period 1 June 2004 to 31 March 2007.

Section 6

Remedies and Impact Assessment

- 6.1 As explained in Sections 4 and 5, in this statement, Ofcom has concluded that H3G has SMP in the market for the provision of mobile wholesale voice call termination on its network. Ofcom therefore needs to consider whether it is appropriate to impose any ex-ante regulatory remedies.
- 6.2 In the H3G reassessment consultation document we included a summary of options in respect of remedies and an Impact Assessment ('IA'), as defined by section 7 of the Act. IAs provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. For further information about our approach to impact assessments, see the guidelines, Better policy-making: Ofcom's approach to impact assessment, which are on our website: http://www.ofcom.org.uk/consult/policy_making/guidelines.pdf.

Aim of the proposal

- 6.3 Ofcom's principal duty in carrying out its functions, as set out in Section 3(1) of the Act, is to further the interests of citizens in relation to communications matters, and to further the interests of consumers in relevant markets, where appropriate by promoting competition. Section 3 (4) states that in performing its duties, Ofcom must have regard to, as far as it appears relevant to Ofcom, among other things: the desirability of promoting competition in relevant markets, and the desirability of encouraging investment and innovation. Section 4 of the Act sets out Ofcom's duties for the purposes of fulfilling Community obligations, and includes promoting competition in relation to the provision of electronic communications networks and services. In regard to Ofcom's proposal outlined in this document, Ofcom has considered its duties among others, as set out below.

Summary of options

- 6.4 As mentioned previously, in June 2004, Ofcom imposed different remedies across the (then) six MNOs. In particular, the four 2G MNOs were subject to charge controls and other conditions, whilst H3G was subject to an obligation to notify Ofcom of its charges for 2G termination and provide information on call volumes in respect of 2G and 3G call termination.
- 6.5 Except for the transparency requirement, Oftel, in the December 2003 CTM review consultation considered the other requirements imposed on the 2G MNOs to be either inappropriate, disproportionate or unjustified for H3G for the following reasons:⁶¹
- Providing network access on fair and reasonable terms was deemed to be less proportionate for H3G because of its nascent state of development;
 - The non-discrimination condition was deemed to be disproportionate since H3G had a small subscriber base and consequently a much larger proportion of off-net traffic than the other MNOs. As a consequence, in Oftel's opinion, H3G would not have the same incentives as the other MNOs to discriminate between MNOs;

⁶¹ See http://www.ofcom.org.uk/consult/condocs/mobile_call_termination/mct_consultation/?a=87101, Chapter 5.

- A charge control for 3G voice call termination services was considered to be inappropriate, since 3G services were new and innovative, take-up was uncertain and costs were difficult to assess;
- A LRIC-based obligation for 2G voice call termination was not considered to be justified, given the difficulties in assessing the costs involved in using a new and innovative 3G service, nor was it considered proportionate because:
 - H3G had strong incentives to use its own 3G network and not another MNOs 2G network; and
 - Enforcing a LRIC obligation would place a significant burden on H3G to provide accurate and updated information.

6.6 At the time of H3G's initial SMP designation in June 2004, Ofcom concluded that a transparency obligation including a reporting requirement was an appropriate obligation to impose on H3G at that stage as it was proportionate to H3G's development in the market. Ofcom at the time considered that the publication of charge changes in advance and the provision of call volume data to Ofcom would have the purpose of assisting transparency for the monitoring of potential anti-competitive behaviour, as well as allowing 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.

6.7 In considering the appropriate remedy in the context of this document, and consistent with the H3G reassessment consultation, Ofcom has considered three options in respect of the appropriate remedy. In considering options for the appropriate remedy, Ofcom has taken account of the fact that H3G has grown significantly in size since H3G's initial designation; that its termination charges, as set out in figure 3.3 are above those of other operators; and the period over which any remedy will be in place.

- Option 1: Do nothing, reliance on ex-post intervention;
- Option 2: Impose a charge control in respect of either 2G or/and 3G; and
- Option 3: Set a transparency obligation on H3G, i.e. the requirement for H3G to notify relevant parties of any changes in its termination charges and quarterly report on call volumes terminated by H3G on 2G and 3G.

Option assessment

Option 1 – Do nothing, reliance on ex-post intervention

6.8 Ofcom potentially could decide not to impose any condition(s) on H3G and instead rely on ex-post competition law. This would have the advantage of reducing the level of ex ante regulatory intervention.

6.9 However, reliance on ex-post competition law has a number of disadvantages. As set out at paragraph F.47 of Policy Annex F of the TSR Phase 2 consultation, the principles of competition law, as they can be derived from the statute and existing case law, do not always provide ready-made solutions to the problems experienced in telecoms markets. While competition law can, where necessary, incorporate such highly technical matters, there is nonetheless a practical case for addressing such issues through sector rules.

- 6.10 Indeed, without the imposition of ex ante regulation to promote actively the development of competition in markets in which competition is not effective, it is unlikely that ex post general competition law powers would be sufficient to ensure that effective competition became established. For example, ex post powers prohibit abuse of dominance rather than the holding of a dominant position. Ex ante powers can be utilised to reduce the level of market power and thereby encourage effective competition to become established.
- 6.11 Additionally, reliance on ex post competition law may not allow for the certainty of intervention that is necessary to give all parties, including MNOs and FNOs, the confidence to plan their businesses and make significant investments within a clear and predictable regulatory environment.
- 6.12 Ofcom therefore does not consider this option to be appropriate.

Option 2 – Impose a charge control - in respect of either 2G or/and 3G call termination

- 6.13 Ofcom could impose charge controls in respect of call termination for either or both calls terminated on 2G and 3G networks to H3G's subscribers. All MNOs apart from H3G are at present subject to controls on the charges for voice call termination on their 2G networks. As a consequence, Ofcom recognises that consistency in remedy may involve the imposition of such on H3G. Ofcom also considers this option in light of the fact that H3G is able to levy a higher (i.e. its own) termination charge on terminating operators when terminating calls on the 2G network with which it has a national roaming agreement, ✕.
- 6.14 As stated in the September 2006 CTM review consultation, Ofcom was at that time in the process of consulting on its cost models, and also its understanding of H3G's cost base. Therefore at the date of the H3G reassessment consultation, Ofcom did not consider, on the basis of the information it had at that time, that proposing a charge control on H3G would be proportionate or practical.
- 6.15 Having now undertaken a full analysis of the relevant costs and having consulted on its cost models, a charge control on H3G might now be considered to be appropriate. However, this was not the position when Ofcom consulted last September. To impose a charge control would now require a new consultation. Given the very short period between publication of this H3G reassessment statement and the expiry of the current charge control period, which runs until the 31 March 2007, Ofcom considers that the application of a charge control on H3G for what remains of the period is not proportionate.
- 6.16 For these reasons Ofcom does not consider this option to be appropriate.

Option 3 – Set a transparency obligation

- 6.17 As mentioned above, in the June 2004 CTM statement, Ofcom considered that the publication of charge changes in advance and the provision of call volume data to Ofcom would have the purpose of assisting transparency for the monitoring of potential anti-competitive behaviour, as well as allowing competing providers sufficient time to plan for charge changes.
- 6.18 The reporting requirement in relation to call volumes is not unduly onerous for H3G in the period up to 31st March 2007 (after which, depending on the outcome of the September 2006 CTM review consultation, potentially new remedies might come into

force), as it does not require publication to anyone except Ofcom of the requested information. It only requires that H3G collates and submits call volume information to Ofcom. Ofcom does not consider this to be unduly burdensome, as the data should be readily available to H3G.

- 6.19 Therefore, as set out in the H3G reassessment consultation, setting a transparency obligation on H3G for the remainder of the current period up to 31 March 2007 is Ofcom's preferred approach.
- 6.20 As such, Ofcom now proposes that H3G should be required to publish, in advance, charge changes, both to Ofcom and those taking wholesale voice call termination services from H3G and provide of call volume data to Ofcom. As set out in paragraph 6.6 this facilitates transparency.
- 6.21 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 Ofcom 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 Ofcom may from time to time direct, the terms and conditions on which he is willing to enter into an access contract.
- 6.22 Therefore, Ofcom has set an SMP service condition that except insofar as Ofcom may otherwise consent in writing, requires H3G to publish its charges and act in the manner set out in the condition – namely to:
- send to Ofcom and to every person with which it has entered into an Access Contract a written notice of any amendment to the charges on which it provides Network Access or in relation to any changes for new Network Access (an 'Access Charge Change Notice') not less than 28 days before any such amendment comes into effect;
 - ensure that an Access Charge Change Notice includes:
 - a description of, and the proposed new charge for, the Network Access in question;
 - where applicable, the current charge for the Network Access in question; and
 - the date on which or the period for which any amendments to charges will take effect (the 'effective date').
 - not to apply any new charge identified in an Access Charge Change Notice before the effective date.
- 6.23 except insofar as Ofcom may otherwise consent in writing, send to Ofcom no later than three months after the end of each Quarterly Period a written notice of:
- a) the volume of minutes of 2G Calls by Charging Period; and
 - b) the volume of minutes of all Calls by Charging Period,
 - c) terminated during the Quarterly Period in question.

- 6.24 The condition MA1 is set out in the Notification at Annex 3, and is unmodified from that in the H3G reassessment consultation, except for the modification to the definition of Quarterly Period.

Legal tests - Ofcom's duties under the Communications Act 2003

Section 3 – Ofcom's general duties

- 6.25 When considering the appropriateness of the remedies proposed in this section, Ofcom has had regard to its duties under the Communications Act 2003 (the 'Act').
- 6.26 Section 3(1) of the Act sets out the principal duty of Ofcom, in carrying out its functions under the Act: to further the interests of citizens in relation to communications matters; and to further the interests of consumers in relevant markets, where appropriate by promoting competition.
- 6.27 Ofcom has also considered when carrying out its functions, amongst other things, the requirements in section 3(2) of the Act to secure the availability throughout the UK of a wide range of electronic communications services and section 3(4) of the Act, namely that in performing its duties Ofcom must also have regard to such of the following as appears to be relevant in the circumstances, in particular:
- The desirability of promoting competition in relevant markets;
 - The desirability of promoting and facilitating the development and use of effective forms of regulation;
 - The desirability of encouraging investment and innovation in relevant markets; and
 - The opinions of customers in relevant markets and of members of the public generally.
- 6.28 As mentioned, section 3(1) of the Act sets out the principal duty of Ofcom. The proposed transparency obligation allows competing providers to adapt to changes in wholesale charges and allows the monitoring of anti-competitive behaviour. Therefore, Ofcom considers that H3G provides the relevant information to it, 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 providers assurances that H3G continues to be appropriately and proportionately regulated.

Section 4 – European Community requirements for regulation

- 6.29 Section 4 of the Act requires Ofcom to act in accordance with the six European Community requirements for regulation. In summary these requirements are to:
- Promote competition in the provision of electronic communications networks and services, associated facilities and the supply of directories;
 - Contribute to the development of the European internal market;
 - Promote the interests of all persons who are citizens of the European Union;

- Not favour one form of or means of providing electronic communications networks or services, i.e. to be technologically neutral;
 - Encourage the provision of network access and service interoperability for the purpose of securing;
 - Efficient and sustainable competition; and
 - The maximum benefit for customers of communications providers; and
 - Encourage compliance with certain standards in order to facilitate service interoperability and secure freedom of choice for the customers of communications providers.
- 6.30 For the reasons set out in paragraphs 6.20 to 6.22 above, and in particular, that it would allow Ofcom to monitor pricing developments, Ofcom has put in place a transparency obligation. Although Ofcom has found, in the course of its most recent review on calls to mobile, that a charge control is required on a forward basis from April 2007 to promote efficient and sustainable competition and to secure the maximum benefit for end users in the medium to long-term, Ofcom considers that for the remainder of this current period, a transparency obligation is proportionate.
- 6.31 As set out under Section 47(1) of the Act, in setting a condition, Ofcom must be satisfied that the test set out under Section 47(2) has been met. The test is that the condition is:
- Objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
 - Not unduly discriminatory against particular persons or against a particular description of persons;
 - Proportionate to what it is intended to achieve; and
 - Transparent in relation to what it is intended to achieve.
- 6.32 Ofcom considers that the condition meets the tests set out in section 47 of the Act. The 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 alter their prices in response to changes in wholesale charges and allows the monitoring of anti-competitive behaviour, whilst notification of call volumes provides transparency thereby ensuring appropriate and proportionate regulation.
 - It does not discriminate unduly against H3G, in that it addresses problems stemming from H3G's SMP in the market whilst reflecting H3G's unique position during this period where it only has a 3G network of its own.
 - It is proportionate, in that only the minimum amount of information required by Ofcom and competitors for monitoring purposes regarding termination charges and termination volumes is required to be published, and in the case of call volumes, the information need only be made available to Ofcom.

- It 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.
- 6.33 Ofcom therefore considers that reinstating the transparency obligation required of H3G in the June 2004 CTM statement is the most appropriate remedy for the period to the end of March 2007.
- 6.34 H3G was the only respondent who commented on the proposed obligation. H3G considered that Ofcom's finding of SMP is wrong in law. However, if SMP were to be found, H3G considered the transparency obligation as described above to be the only proportionate and appropriate remedy.
- 6.35 Ofcom has added the wording "(or any subsequent amendment or replacement Act)" at the end of each of the mobile operator definitions in the Notification, in anticipation that section 736 of the Companies Act 1985 as amended by the Companies Act 1989 will eventually be replaced by section 1159 of the Companies 2006 Act.
- 6.36 Ofcom's Notification and SMP services Conditions are set out in Annex 3 to this H3G reassessment statement. This SMP services condition will remain in place until the end of March 2007.

Annex 1

The CAT's judgment and evidence relating to the negotiation of the initial agreement

The CAT's findings concerning Ofcom's assessment of the existence and extent of BT's CBP in Ofcom's June 2004 CTM statement

A1.1 The CAT's judgment concluded that:

"OFCOM erred in its determination as to the existence of significant market power because it did not carry out a full assessment of the extent to which BT had countervailing buyer power."⁶²

A1.2 In its judgment, the CAT considered:

"... that there were two errors. The first is the determination or assumption that the end-to-end connectivity obligation removed any bargaining power BT might otherwise have had, with the effect that the likely or possible future commercial scenarios were not considered by OFCOM. The second is an apparent misunderstanding of OFCOM's powers in relation to dispute resolution. Ultimately these factors are linked."⁶³

A1.3 Consequently, the CAT noted that the full factual position must be looked at, including how far regulation will apply in any negotiation.⁶⁴

Evidence seen by Ofcom

A1.4 During the course of the proceedings, the CAT had the opportunity to review much of the background material relating to the negotiation of the initial agreement between H3G and BT, which was concluded at the end of January 2002. We have seen further material submitted by both parties under Section 135 requests by Ofcom, that relate to this period. In brief:

- negotiations between the parties began in late 2001;
- a standard Interconnect Agreement between H3G and BT was signed on 13 August 2001, but without the termination charge schedule which would set out the price for the service;
- on 16 November 2001, H3G proposed offering its service at the existing BT charge band applicable to Dolphin (fm2, i.e. daytime 17.5 ppm, evening 12.2 ppm, weekend 5.3 ppm) on an interim basis for testing purposes, declaring its intention to negotiate a final termination rate before its intended launch;

⁶² See the CAT's judgment, paragraph 145.

⁶³ See the CAT's judgment, paragraph 118.

⁶⁴ See the CAT's judgment, paragraph 142.

- BT replied on 3 December 2001 refusing to accept the rate in the absence of a cost justification and later suggested that H3G might propose the termination charges of an existing 2G MNO;
- H3G proposed charging the rates employed by One2One (now T-Mobile) (i.e. daytime 15.62 ppm, evening 10.78 ppm, weekend 2.51 ppm) on 24 December 2001 on an interim basis;
- H3G and BT entered into a Supplemental Agreement on the basis of the One2One rates on 29 January 2002.

A1.5 The CAT's judgment makes a number of observations regarding this period, based on its review of the evidence:⁶⁵

- H3G was under some time pressure because it wished to test and launch its product in the first half of 2002. There was an increasingly urgent need to finalise the termination rates towards the end of 2001, partly as a consequence of BT's internal procedures. However, the problems did not arise from delays created by BT. So far as things became urgent, they arose from a failure by H3G over a couple of months to propose rates and subsequently support its proposals;
- While H3G may have been vulnerable to delays created by BT, there is no evidence that BT did anything at any time which might be regarded as introducing unnecessary or tactical delays. On the evidence, it dealt with the negotiations with appropriate expedition throughout; and
- BT did not reject H3G's first pricing proposal out of hand, or indeed reject it in any meaningful sense. It simply said that it would require the adoption of that band to be justified by H3G. H3G chose not to provide evidence to support its initial price and decided instead to suggest another price band to BT.

A1.6 Although some of the evidence⁶⁶ shows that BT was aware of H3G's sensitivity to delay, our review of all the evidence (including additional evidence from that period not submitted to the CAT, but submitted following information requests by Ofcom) shows that BT did not create any delays, nor did it consider whether to do so and this further evidence confirms the CAT's view.

A1.7 Our review of evidence⁶⁷ submitted by H3G shows that:

- H3G was concerned about the risk that it might be regulated by Oftel and its prices could become subject to charge controls in the longer term;
- It was concerned about the delay that might result if BT sought to request Oftel's intervention and, while itself considering whether to refer, did not do so because of concerns regarding delay; and
- It wanted to ensure that the interconnection rates it achieved were consistent with those anticipated in its business plans.

⁶⁵ See the CAT's judgment, paragraph 81.

⁶⁶ Email exchange between BT and H3G dated 3 December 2001

⁶⁷ Internal H3G papers on Call termination charging: Call termination Charging, A proposal for an interim (pre-launch) and post launch strategy dated 6 and 11 November 2001, and internal H3G email dated 5 November 2001.

Post agreement events

- A1.8 During the course of the CAT proceedings, H3G had argued that the interim price agreed between H3G and BT was “embedded”⁶⁸ and submitted evidence from H3G’s then regulatory director that H3G was constrained from seeking to terminate the agreement or renegotiate the termination charge.⁶⁹
- A1.9 As the CAT observed, “embedded” is not the right term. The provisions for variation, termination and renegotiation of the agreement demonstrate that the terms were not fixed.⁷⁰ Further, the CAT identified potential inconsistencies between H3G’s then regulatory director’s evidence that H3G was not able to renegotiate the termination charge and further evidence relating to the negotiations. The CAT considered that evidence to demonstrate the possibility of fixing an initial price for launch which would subsequently be varied prior to launch and that this was considered by both sides as a perfectly acceptable business mechanism. It noted that there was nothing to suggest that adopting such a process would in any way affect the relationship between H3G and BT and that this would seem to be contrary to the H3G’s then regulatory director’s evidence.
- A1.10 Further evidence provided to us concerning negotiations between H3G and BT in March and April 2002, following the initial agreement, confirms that until a relatively late stage both parties expected that they would agree a final termination rate which would vary the “initial” rate agreed between them.
- A1.11 It appears that in a meeting on 26th March 2002, H3G floated to BT the possibility of proposing a flat rate charge across all times of day. An internal BT email states that three different retail rates were discussed.⁷¹ BT noted that H3G was free to propose changes in tariffs at any point in time, by issuing an Operator Charge Change Notice (OCCN). The minutes of the meeting on 26 March 2002⁷² as drafted by H3G, record H3G’s intention to negotiate a “launch” termination rate:
- “Given the long timescales for negotiation and implementation of changes in BT’s systems, H3G believes it is necessary to initiate discussions for a change to H3G’s termination charges now, in order to be in place for launch. H3G considers the current termination charges to be an interim position agreed solely to expedite network testing.
- H3G intends that interconnect charges will be determined in line with its general pricing strategy, as far as possible. To that end, H3G proposed that the interconnect charge would be negotiated on a commercial basis between H3G and BT, mindful of the regulation which is associated with interconnect charges and retail pricing.”
- A1.12 BT conducted internal analysis in preparation for the follow up meeting on 23rd April 2002 and in expectation of a formal proposal of a flat rate price from H3G. At this meeting, BT stated that they had no objections in principle to a flat rate approach but pointed out a number of practical difficulties, including the need for BT to maintain its retention. BT also said that it would seek justification of the costs of any proposed

⁶⁸ See the CAT’s judgment, paragraph 84.

⁶⁹ See the CAT’s judgment, paragraph 85.

⁷⁰ See the CAT’s judgment, paragraph 84.

⁷¹ Internal BT email dated 4 April 2002.

⁷² As attached to an internal H3G email, dated 9 May 2002.

rate. In the event, it appears that H3G was already reaching the view that it would be preferable not to pursue a new “launch” termination rate in place of its “interim” termination rate. In a draft internal paper, circulated in an attachment to an e-mail of 18 April 2002, it notes:

“Subsequent to BT and H3G reaching an agreement on interconnect the Competition Commission has initiated an inquiry into the price of calling to mobiles, which is concerned primarily with mobile network termination charges. In the UK and across Europe, there is considerable regulatory pressure for mobile termination charges to fall. As a result of this pressure, it is very unlikely that H3G will be able to negotiate an increase to the “interim” interconnect charges it has arranged.”

- A1.13 The note contained a summary table that showed that although the interim rate would put H3G’s termination income slightly behind business plan assumptions at the start of the planning period in 2002, the business plan had also assumed that H3G’s termination revenue per minute would be subject to an annual decrease. By maintaining the interim rate over time (and not decreasing it on an annual basis), H3G would be expected to achieve termination income ahead of its business plan expectations in later years.
- A1.14 H3G’s mention of a reference to the Competition Commission relates to the reference made on 7 January 2002 under section 13 of the Telecommunications Act 1984 concerning the wholesale mobile voice termination charges made by Vodafone, BT Cellnet, Orange and One2One. The Competition Commission reported in December 2002 and recommended modifications to the licences of Vodafone, BT Cellnet, Orange and One2One. These modifications required reductions to average termination charges on 2G networks to take effect before 25 July 2003; it also suggested subsequent reductions in each year to 31 March 2006. Ofcom implemented the recommended reductions by July 2003 and following the market review completed in June 2004, imposed further reductions on the 2G termination charges of Vodafone, Orange, O2 (formerly BT Cellnet) and T-Mobile (formerly One2One).
- A1.15 H3G’s termination charges were not included in the terms of reference to the Competition Commission. Nevertheless, H3G participated in the inquiry as an interested party.
- A1.16 During the course of a hearing on 8 October 2002, the Competition Commission explored H3G’s concerns that the regulation of the other MNOs would have consequences for H3G’s own unregulated termination charges. During the course of the hearing, H3G expressed the view that:

“It is very unlikely that we would be able to sustain termination charges and hence calls to our network which are substantially different from the other networks.

Now, I understand you have some misgivings over the transparency of that, but just in terms of the market that I am in, I cannot see that we would be able to get away with termination charges significantly above where the others were.”⁷³

⁷³ Transcript of H3G’s hearing at the Competition Commission in the context of the ‘Mobile Phone Inquiry’, 8 October 2002, page 9 and 10.

A1.17 H3G launched its service using the One2One set of prices (fm3) in 2003. At that time, One2One (now T-Mobile) had the highest of the 2G termination rates. Following regulatory intervention, T-Mobile reduced its rates in July 2003 from an average of 11.2ppm to 9.63ppm. H3G did not follow this reduction. There was a further regulatory reduction in T-Mobile's rates in July 2004 reducing them to 6.31ppm. Again, H3G did not track the reduction in T-Mobile's rates and maintained its rates. As a consequence of the rate reductions required of the other MNOs, and as shown in Figure A1.1 below, H3G's termination rate is currently significantly higher than those of the other MNOs.

Figure A1.1 current blended wholesale termination charges as at 1 March 2007⁷⁴

	Daytime (ppm)	Evening (ppm)	Weekend (ppm)
Vodafone	8.22	3.34	2.74
O2	6.845	6.778	3.422
Orange	7.5	5.7312	5.7312
T-Mobile	8.00	6.15	6.15
H3G	15.62	10.78	2.51

A1.18 None of the respondents to the H3G reassessment consultation have commented on our presentation and interpretation of the evidence regarding the initial agreement and the post-agreement developments.

A full chronological sequence of the initial negotiations

A1.19 The negotiations between BT and H3G began in late 2000. Following the conclusion of a confidentiality agreement between BT and H3G on 14th February 2001, an email exchange took place between the parties in order to progress an agreement on interconnection. BT sent H3G its Customer Requirements Definition, outlining the requirements for interconnection including details of the operator, technical information and required products and services.

A1.20 In April 2001 BT initiated a workshop with H3G where the BT Pricing team took H3G through the issues concerning interconnect pricing, contracts, call types, charges and other related matters. BT sent a follow up email indicating that it would be happy to guide any H3G staff through the BT Wholesale Carrier Price List.

A1.21 Between early July and early October 2001 four working group meetings were held between BT and H3G in relation to several contractual and technical aspects of interconnection. In the minutes of the meeting on 1st August, reference was made to an 'interim' price, to be agreed between H3G and BT for the testing phase.

A1.22 On 13th August 2001 a Standard Interconnection Agreement was signed between H3G and BT, without the termination charge schedules.

A1.23 There was subsequently some debate as to the timescales and mechanism by which H3G could agree its "interim price" and subsequently change this to a final "launch" price for termination. BT's reading of the contractual provisions was that an 'interim price' could be agreed through the standard termination contract (on the basis of the timetable set out in that contract) and that if H3G wished to change the tariff at launch (at the time planned for June 2002), it could initiate an OCCN ("Operator Charge Change Notice") which would then kick-off commercial negotiation of a new

⁷⁴ Many of the charges quoted remain the subject of contractual negotiation and/or dispute

range of charges. BT noted that it was not in a position to agree an interim price for interconnection outside standard industry procedure, citing, amongst other things, non-discrimination obligations on its part. An implication of the timetable set out in the agreement was that, by that stage, H3G decided to use an existing BT price band in order to meet its launch timetable and allow subsequent negotiations to proceed without delay.

A1.24 On 16th November 2001, H3G sent an email to BT to propose a charge at the “fm2” price point (i.e. the existing charge band then applicable to Dolphin). BT replied to H3G by email to ask it to confirm that the proposal amounted to the following termination rates:

Day: 17.5 ppm

- Evening: 12.2 ppm
- Weekend: 5.3 ppm

A1.25 On 3 December 2001, BT sent an e-mail to H3G, rejecting its proposal in the following terms:

“BT notes that Hutchison 3G’s assessment that the proposed service does not fall under the existing regulatory framework for fixed to mobile calls. BT believes that the agreement of termination rates between BT and Hutchison 3G should be determined by commercial negotiation.

In the absence of cost justification from Hutchison 3G, BT has reached the conclusion that the proposed termination rates, being significantly higher than call charges to other existing GSM services, represent too high a cost for BT’s retail customers. BT therefore does not agree to the proposed rates and seeks to enter into negotiations with Hutchison 3G with a view to agreeing termination rates that are acceptable to both parties.”

A1.26 H3G replied to BT’s email on 3 December stating that this rate is for test purposes and was not part of the commercial offering. H3G also asked BT to propose a rate which would be acceptable to BT and expressed concern about delays and time lines.

A1.27 On 5 December 2001, a meeting took place between H3G and BT where BT explained why H3G’s proposal was rejected by BT. The note of that meeting recorded BT’s explanation that:

“- BT is considering H3G’s proposal in the context of other termination charges and retail prices in the market;

- H3G’s suggestion that these charges and prices would only apply to test traffic was not relevant, since implementation of the price for the test number range means that the test number would be open for all BT customers to call;

- BT did not wish to differentiate the service that it is offering to H3G.”

A1.28 The note goes on to record BT's explanation that it believed that H3G was not offering BT a different service to that offered by a GSM operator. H3G argued that GSM and 3G networks are not similar. BT replied that if H3G proposed a different charge to that of an existing GSM operator, then the proposal would need to be accompanied by a justification of H3G's costs in respect of providing the service. H3G stated that it did not accept that its termination charges should be equivalent to charges of a regulated operator with market influence, as H3G is not subject to regulation of its interconnect charges.

A1.29 In that meeting, BT proposed that H3G could either submit a new proposal for interconnect charges, or BT and H3G could refer the dispute to Oftel for determination. It suggested that H3G might adopt an existing mobile operator's termination charges, specifically suggesting those of Cellnet. BT also pointed out to H3G that if H3G were to use one of the existing mobile operators' termination rates, H3G would not be bound to the price cap set by Oftel for the regulated operators.

A1.30 On 24th December 2001 H3G sent a letter proposing a new "interim rate". It proposed to use fm3, which at the time was the termination rate charged by One2One and was the highest rate of any of the four incumbent 2G MNOs. BT accepted H3G's proposed termination rates by email dated 29 January 2002. The Supplemental Agreement was subsequently signed. The proposed charges were as follows:

Day: 15.62 ppm;

- Evening: 10.78 ppm; and
- Weekend: 2.51 ppm .

A1.31 No fixed term was agreed for the purpose of the Initial Agreement, but the duration of the Agreement is determined by the following factors:

- either Party may terminate the Agreement by giving notice of not less than 24 months (paragraph 2.3);
- in the event that either Party ceases to be a Schedule 2 Public Operator the Party so ceasing may terminate by not less than three months written notice (while the other Party may terminate by not less than one months written notice) (paragraph 2.2);
- after a notice has been given a Party may request the other Party to carry on good faith negotiations with a view to entering into a new agreement (paragraph 2.4); and
- if upon termination either Party would be obliged under its Licence to enter into a new interconnection agreement with the other Party, "the Parties shall carry on good faith negotiations with a view to entering into a new agreement within a reasonable period and in the case of paragraphs 2.2.1 or 2.3 with a view to that agreement taking effect on termination of this Agreement "(paragraph 2.5).

A1.32 In respect of changes of price the Initial Agreement sets out that either Party may notify the other from time to time of a request for variation to a charge (called an OCCN). Upon receipt, the receiving Party must - within 14 days if the recipient is another operator, within "a reasonable time" in the case of BT - notify the other Party of its acceptance or rejection of the proposed variation.

A1.33 Where an OCCN is rejected, the Initial Agreement provides that the Parties “*shall forthwith negotiate in good faith*”. The Agreement foresees that in the event that both Parties agree that the charge change notice requires modification, the Party who sent the OCCN may send a further OCCN. If the OCCN is again rejected, and the “*Parties fail to reach agreement within 14 days of the rejection of the OCCN, either party may ... refer the matters in dispute to the Director General*”.

Annex 2

Recent developments in respect of H3G's mobile voice call termination rate

A2.1 Prior to publishing the H3G reassessment consultation document, Ofcom requested information from BT and H3G that covered:

- Evidence of any requests for changes (either by H3G or by BT) or amendments to H3G's mobile voice call termination rate or other terms and conditions of the interconnection contract between H3G and BT), including any evidence of internal views concerning any such changes; and
- Evidence of any considerations by H3G or BT to refer a dispute to Ofcom in respect of H3G's mobile voice call termination rate or other terms and conditions of the interconnection contract between H3G and including any evidence of internal views concerning referring a dispute to Ofcom.

A2.2 ✕

Update on discussions since the September H3G reassessment consultation

A2.3 Prior to publication of this H3G reassessment statement, Ofcom again requested information from H3G and BT on issues that might be relevant. This additional information request covered, in particular:

- Provision of copies of correspondence relating to charges or the negotiation of charges for the possible purchase or supply of MCT, for the period August 2006 to February 2007.
- Provision of internal information/correspondence relating to charges or the negotiation of charges for the possible purchase or supply of MCT, for the period August 2006 to February 2007.

A2.4 ✕.

A2.5 On 22 January 2007 BT referred the matter to Ofcom for dispute resolution. Ofcom is presently considering that reference.

A2.6 Ofcom recognises, that H3G's recent ✕, is relevant in the context of an assessment of whether suppliers have SMP and whether any purchasers have CBP.

A2.7 However, any analysis of the existence of SMP in a given market must be undertaken within a framework which assumes, for the purpose of the assessment that the market is not subject to regulation or the threat of regulation arising from a finding of SMP within that market. Ofcom considers that the behaviour of BT and H3G, in respect of their recent confidential proposals with respect to MCT charges has been strongly conditioned by the existence or threat of SMP regulation in these markets.

A2.8 For example, in correspondence between BT and H3G in September. ✕.

A2.9 As such, Ofcom does not consider that the behaviour of BT or H3G mirrors the behaviour likely to be observed absent regulation or the threat of regulation.

A2.10 Finally, having reviewed the latest documentation obtained by Ofcom from BT and H3G regarding negotiations between the two parties since the publication of the H3G re-assessment consultation, Ofcom does not consider that this changes the analysis presented in the H3G reassessment consultation. Ofcom continues to consider that that the level of CBP BT has is insufficient to counter H3G's SMP in the relevant market.

Annex 3

Notification

The identification of a market, the making of a market power determination and the setting of SMP services conditions, in relation to H3G

NOTIFICATION UNDER SECTIONS 48 (1) AND 79 (4) OF THE COMMUNICATIONS ACT 2003

WHEREAS

(A) The Office of Communications (“OFCOM”) issued a notification pursuant to section 48(2) and section 80 of the Communications Act 2003 (the “Act”) setting out their proposals for the identification of a market, the making of a market power determination and the setting of SMP services conditions on 13 September 2006 (the “First Notification”);

(B) A copy of the First Notification was sent to the Secretary of State in accordance with section 50 (1)(a) of the Act, and to the European Commission and to the regulatory authorities of every other member state in accordance with sections 50(3) and 81 of the Act;

(C) In the First Notification and the accompanying explanatory statement, OFCOM invited representations about any of the proposals set out therein by 25 October 2006;

(D) By virtue of section 80(6) of the Act, OFCOM may give effect to any proposals to identify a market for the purposes of making a market power determination or any proposals for making a market power determination set out in the First Notification, with or without modification, where -

(i) they have considered every representation about the proposals made to them within the period specified in the First Notification; and

(ii) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State; but

OFCOM’s power to give effect to such proposals is subject to sections 82 and 83 of the Act;

(E) By virtue of section 48(5) of the Act, OFCOM may give effect to any proposals to set SMP services conditions set out in the First Notification, with or without modification, where:

(i) they have considered every representation about the proposals made to them within the period specified in the First Notification; and

(ii) they have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State;

(F) OFCOM received responses to the First Notification and have considered every such representation made to them in respect of the proposals set out in the First Notification and the accompanying explanatory statement; and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose;

(G) The European Commission has not made a notification for the purposes of Article 7(4) of the Framework Directive as referred to in section 82 of the Act and the proposals do not relate to a transnational market as referred to in section 83 of the Act;

THEREFORE

1. OFCOM in accordance with section 79 of the Act identify the following market for the purposes of making a market power determination:

(a) wholesale voice call termination provided by H3G (such termination being provided via H3G's mobile network).

2. OFCOM in accordance with section 79 of the Act make the following market power determinations in relation to the markets referred to in paragraph 1 above-

(a) in relation to the market in sub-paragraph 1(a) above, H3G;

3. OFCOM in accordance with section 48(1) of the Act and section 79 of the Act hereby set pursuant to section 45 of the Act the SMP services conditions on the persons referred in paragraph 2 above as set out in Schedule 1 to this Notification to take effect, unless otherwise is stated in those Schedules on the date of publication of this Notification.

4. The effect of and OFCOM's reasons for the decisions referred to in paragraphs 1 to 3 above are contained in the Explanatory Statement accompanying this Notification.

5. For the avoidance of doubt, the Notification at Annex A, Schedule 1, in the wholesale mobile voice call termination market review that relates to H3G, published by Ofcom in June 2004 shall be revoked by this proposed Notification when it takes effect under Section 48(1) and 79(4) of the Act.

6. In making the decisions referred to above, OFCOM have taken due account of all applicable guidelines and recommendations which have been issued or made by the European Commission in pursuance of a Community instrument, and relate to market identification or analysis, as required by section 79 of the Act.

7. In making the decisions referred to in paragraphs 1 to 3 above, OFCOM have considered and acted in accordance with the six Community requirements set out in section 4 of the Act and their duties in section 3 of the Act.

8. OFCOM consider that the SMP services conditions referred to in paragraph 3 above comply with the requirements of sections 45 to 50 and sections 78 to 92 of the Act, as appropriate and relevant to each such SMP services condition.

9. Copies of this Notification and the accompanying explanatory statement have been sent to the Secretary of State in accordance with section 50(1)(a) and section 81(1) of the Act and to the European Commission in accordance with sections 50(2) and 81(2) of the Act.

10. Save for the purposes of paragraph 1 of this Notification and except as otherwise defined in this Notification, words or expressions used shall have the same meaning as in the Act.

11. In this Notification:

“**Act**” means the Communications Act 2003;

“**H3G**” means Hutchison 3G (UK) Limited (registered company number 3885486) including any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;

Neil Buckley

Competition Policy Director

A person authorised by OFCOM under paragraph 18 of the schedule to the Office of Communications Act 2002

27 March 2007

SCHEDULE

The SMP services condition proposed to be imposed on H3G under sections 45 and 87 of the Communications Act 2003 as a result of the analysis of the market set out in paragraph 1.3 of this Notification ('SMP condition').

Part 1: Application, definitions and interpretation relating to the SMP condition in Part 2

1. The SMP condition in Part 2 of this schedule shall, except insofar as it is otherwise stated therein, apply to the market set out in paragraph 2.2 of this Notification.

2. In this Schedule:

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

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

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

For the purposes of this definition:

- a) 'the relevant standards of the European Telecommunications Standards Institute' means the European Telecommunications Standards (ETS) of ETS 300 905 (GSM 02.03 version 5.3.2), Third Edition, January 1998, which has been produced by the Special Mobile Group of the European Telecommunications Standards Institute; and
- b) 'GSM' means the Global System for Mobile communications, as defined in the relevant standards of the European Telecommunications Standards Institute;

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

'3G Call' means a circuit switched conveyance of a speech teleservice only (as defined in the relevant standards of the 3rd Generation Partnership Project) originating in a Public Electronic Communications Network (whether fixed or mobile) and which terminates on a mobile handset which is connected to the 3G Public Electronic Communications Network of the Dominant Provider.

For the purposes of this definition 'the relevant standards of the 3rd Generation Partnership Project' means the following standards of the 3rd Generation Partnership Project:

Assessment of whether H3G holds a position of SMP in the market for wholesale mobile voice call termination on its network

- a) 3G TS 22.001 V3.2.0 (2000-03) (Technical Specification: Digital cellular telecommunications system (Phase 2+), Technical Specification Group Services and System Aspects, and Principles of circuit telecommunication services supported by a Public Land Mobile Network (PLMN)) (Release 1999);
- b) 3GPP TS 22.002 V3.6.0 (2001-03) (Technical Specification: Technical Specification Group Services and Systems Aspects, and Circuit Bearer Services (BS) supported by a Public Land Mobile Network (PLMN)) (Release 1999);
- c) 3G TS 22.003 V3.3.0 (2000-06) (Technical Specification: Technical Specification Group Services and Systems Aspects, and Circuit Teleservices supported by a Public Land Mobile Network (PLMN)) (Release 1999); and
- d) 3GPP TS 22.101 V 3.17.0 (2004-03) (Technical Specification: Technical Specification Group Services and Systems Aspects, Service Aspects and Service principles) (Release 1999);

'Access Charge Change Notice' has the meaning given to it in Condition MA1.2;

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

'Act' means the Communications Act 2003;

'Call' means a 2G call or a 3G Call;

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

'Dominant Provider' means Hutchison 3G UK Limited whose registered company number is 3885486 and Hutchison 3G (UK) Limited subsidiary or holding company, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989.

'Network Access' means those services, facilities or arrangements which are necessary to terminate a 2G Call;

'Ofcom' means the Office of Communications; and

'Quarterly Period' means a consecutive three month period, the first of which begins on 27 March 2007

For the purpose of interpreting the SMP condition in Part 2 of this Schedule:

- Except insofar as the context otherwise requires, words or expression shall have the meaning ascribed to them in paragraph 2 above and otherwise any word or expression shall have the same meaning as it has in the Act;
- The Interpretation Act 1978 shall apply as if the SMP Condition were an Act of parliament; and
- Headings and titles shall be disregarded.

Part 2: The SMP condition

Condition MA1 – Requirement to notify charges and call volumes

MA1.1 Except insofar as Ofcom may otherwise consent in writing, the Dominant Provider shall publish charges and act in the manner set out below.

MA 1.2 The Dominant Provider shall send to Ofcom and to every person with which it has entered into an Access Contract a written notice of any amendment to the charges on which it provides Network Access or in relation to any changes for new Network Access (an 'Access Charge Change Notice') not less than 28 days before any such amendment comes into effect.

MA1.3 The Dominant Provider shall ensure that an Access Charge Change Notice includes:

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

MA1.4 The Dominant Provider shall not apply any new charge identified in an Access Charge Change Notice before the effective date.

MA1.5 Except insofar as Ofcom may otherwise consent in writing, the Dominant Provider shall send to Ofcom no later than three months after the end of each Quarterly Period a written notice of:

- a) the volume of minutes of 2G Calls by Charging Period; and
- b) the volume of minutes of all Calls by Charging Period,

terminated during the Quarterly Period in question.