

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

Consultation

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## Section 1

# Summary

- 1.1 Wholesale mobile voice call termination 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, Ofcom 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 mobile network operator ('MNO') and that each operator had Significant Market Power ('SMP') in its respective market over the period June 2004 to April 2006.
- 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 to give advance notification of price changes and provide Ofcom with details of call volumes. A sixth operator, Inquam was subject to a requirement to give advance notification of price changes.
- 1.5 H3G subsequently appealed Ofcom's determination that it had SMP to the Competition Appeals Tribunal ('the CAT'), on the grounds, among others, that Ofcom did not carry out a sufficient analysis of prices 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.<sup>1</sup>
- 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.
- 1.7 For this review, the period under consideration is June 2004 to 31 March 2007, following an extension of the charge control which was set in June 2004.

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

## Assessment of whether BT has CBP

- 1.8 In this consultation, Ofcom has, in accordance with the CAT's judgment and order, considered and taken into account all available evidence which relates to the relative positions of BT and H3G in negotiating the price that H3G would charge BT for mobile voice call termination on its network. 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 regulatory intervention may have on BT's CBP.
- 1.9 Relevant to this consultation is Ofcom's statement on end-to-end connectivity, which has been published today as well. In this statement Ofcom gives effect to its proposal as set out in the consultation document entitled *End-to-end connectivity*<sup>2</sup> to impose an obligation on BT to ensure end-to-end connectivity.

## Proposed conclusion on CBP

- 1.10 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 initial view is that BT has not been able and is unlikely over the period of assessment to be able to exert CBP through a threat either to purchase the service from an alternative source or to self-supply.
- 1.11 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.
- 1.12 Should a stalemate situation occur in terms of the 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. Indeed, in the absence of an SMP finding, if a dispute were referred, Ofcom would be unlikely to set a charge at the competitive price level.
- 1.13 H3G's mobile voice call termination rates have remained stable, although the termination charges of the other 2G MNOs have been reduced substantially.
- 1.14 The evidence shows that the level of CBP held by BT is unlikely to be sufficient to overturn the strong prima facie indicators of SMP flowing from H3G's 100% market share and the absolute barriers to entry.

## Other relevant SMP criteria

<sup>2</sup> See [http://www.ofcom.org.uk/consult/condocs/end\\_to\\_end/](http://www.ofcom.org.uk/consult/condocs/end_to_end/).

- 1.15 As part of Ofcom's reconsideration of whether H3G has SMP in the relevant market and as set out in the CAT's order, Ofcom has 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 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.
- 1.16 In looking at the evidence, Ofcom's initial view on these factors is 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 April 2007 and which preclude potential competition.
  - In parallel with this consultation, Ofcom has today published a third and final consultation entitled *Mobile call termination* ('the third consultation').<sup>3</sup> In this consultation Ofcom proposes that the relevant market is the market for wholesale mobile voice call termination provided to other operators by each MNO in the UK and that each has SMP in this market.
  - The results of the 3G cost modelling as published in the third consultation indicate that the 3G charges presently levied by H3G are significantly above Ofcom's proposed view of the appropriate charges for mobile call termination that is subject to consultation. While Ofcom in this document does not rely on this criterion for the re-assessment of H3G's SMP, it is not inconsistent with our proposed conclusion.

### **Initial conclusions**

- 1.17 Ofcom proposes 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, there are absolute barriers to entry and Ofcom considers that BT did not and will not, over the period under consideration, have sufficient CBP to constrain H3G's prices to a competitive level.
- 1.18 In light of this initial view, Ofcom proposes to designate H3G as having SMP in the market for wholesale mobile voice call termination on its own network.
- 1.19 Additionally, Ofcom proposes to set a transparency obligation on H3G for the period until 31 March 2007.

<sup>3</sup> See consultation document 'Mobile Call Termination', published 13 September 2006, [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_term/](http://www.ofcom.org.uk/consult/condocs/mobile_call_term/).

## Section 2

# Background

### The legal framework

- 2.1 A new regulatory framework for electronic communications networks and services ('the new regulatory framework') entered into force in the United Kingdom on 25 July 2003. The basis for this framework is five EU Communications Directives that are designed to create harmonised regulation across Europe. Four of these Directives have been implemented in the UK via the Communications Act 2003 ('the Act').
- 2.2 The Act provides for functions powers and duties to be carried out by Ofcom which include, among other things, functions, powers and duties flowing from the four EU Communications Directives referred to above.
- 2.3 The Framework Directive (Directive 2002/21/EC) provides the overall structure for the regulatory regime and sets out rules and objectives which read across all the new directives. Article 8 of the Framework Directive sets out three key policy objectives which have been taken into account in the preparation of this consultation document; namely the promotion of competition, development of the internal market and the promotion of the interests of the citizens of the European Union.

### Ofcom's prior reviews of the markets for wholesale voice call termination

- 2.4 In line with the requirements of the Framework Directive, Oftel issued a consultation on 1 May 2003 entitled *Review of mobile wholesale call termination markets* ('the May consultation').
- 2.5 In that document, Oftel explained that the Director General of Telecommunications ('the Director') was reviewing competition in the provision of wholesale mobile call termination, and included proposals for identifying markets, making market power determinations and setting significant market power ('SMP') conditions on six mobile network operators ('MNOs'): O2, Orange, T-Mobile, Vodafone, H3G, and Inquam. Following responses to the May consultation, Oftel published a second consultation and Notification (under sections 48(2) and 80 of the Act) and Explanatory Statement on 19 December 2003 ('the December consultation').
- 2.6 After receiving responses to the December consultation, including submissions from the European Commission,<sup>4</sup> Ofcom issued a statement on 1 June 2004 on wholesale mobile voice call termination ('the June 2004 statement'), in which it set out its findings identifying markets, making market power determinations and setting SMP conditions. In summary, Ofcom:
  - Identified separate markets for wholesale voice call termination provided by each MNO's individual mobile network;
  - Concluded that each MNO has SMP in the market for the provision of wholesale voice call termination on its individual mobile network(s); and

<sup>4</sup> The European Commission and other NRAs were sent the draft decisions in accordance with Article 7 of the Framework Directive and sections 50 and 51 of the Act. In response, the European Commission did not exercise its powers under Article 7(4) of the Framework Directive to take a decision requiring Ofcom to withdraw the proposals.

- As a result, set out SMP conditions to be imposed on the six MNOs. The proposed SMP conditions varied as between different MNOs to reflect their different positions as mobile operators.

2.7 The SMP conditions imposed were as follows:

- In respect of Vodafone, O2, T-Mobile and Orange for their 2G voice call termination services:
  - a charge control, to last until 31 March 2006;
  - the provision of network access on reasonable request;
  - the requirement not to unduly discriminate in relations to matters connected with such network access;
  - the requirement to supply to Ofcom copies of any new or amended access contracts; and
  - the requirement to give advance notification of price changes.
- In respect of Inquam, a requirement to give advance notification of price changes; and
- 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.

2.8 On 28 July 2004, H3G appealed Ofcom's determination in the June 2004 Statement that H3G has SMP to the Competition Appeal Tribunal ('the CAT') under section 192 of the Act. H3G did not challenge Ofcom's definition of the relevant market, nor the finding that H3G held (and was likely to continue to hold) a 100% share of that market. H3G also did not challenge the finding that there were absolute barriers to entry to the market. However, H3G mounted four principal attacks on the June 2004 Statement:<sup>5</sup>

- Ofcom did not carry out a sufficient analysis of prices to entitle it to come to a decision that H3G had SMP;
- Ofcom failed to take into account, or sufficient account, of restraints on H3G's ability to increase prices arising from regulation;
- Ofcom failed to take account, or sufficient account, of the ability of customers (principally BT) to restrain pricing;
- H3G's case is that as a result of these failures, and looking at the matter overall, Ofcom did not carry out the exercise required of it if it were to find SMP, and that its decision is therefore flawed.

2.9 A hearing of H3G's appeal was held from 23 May 2005 to 26 May 2005.

2.10 On 7 June 2005, Ofcom published a consultation document entitled *Wholesale mobile voice call termination – a preliminary consultation* ('the preliminary

<sup>5</sup> See the CAT's judgment, paragraph 35.



consultation'). That consultation commenced an analysis of the issues which would need to be addressed during the next review of the wholesale mobile voice call termination market, to be completed before the current remedies expired on 31 March 2006. At the same time, Ofcom consulted on and subsequently published a Statement and notification on 16 December 2005 extending the remedies on the MNOs for a further year, to 31 March 2007.<sup>6</sup>

- 2.11 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 CBP."<sup>7</sup> 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."<sup>8</sup>
- 2.12 On 30 March 2006, Ofcom published a consultation document ('the March consultation') setting out its initial views on market definition, SMP and the options for future regulation after 31 March 2007. The consultation document sets out, among other things, Ofcom's proposed view that:
- As found in the June 2004 Statement, there are separate markets for mobile voice call termination by 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 above the competitive level;
  - These market definitions and the existence of SMP are unlikely to change during the time frame of the CTM review (4 years from March 2007).
- 2.13 The third consultation which has been published today goes on to seek views on a number of specific proposals for regulation of wholesale mobile voice call termination, including a single charge control for each MNO to apply irrespective of whether a call is terminated on their 2G or 3G network. Ofcom anticipates that the statement for the CTM review will be published in early 2007.

<sup>6</sup> Wholesale mobile voice call termination, Statement and notification extending the charge controls, See [http://www.ofcom.org.uk/consult/condocs/wholesale/wmvct\\_statement/statement.pdf](http://www.ofcom.org.uk/consult/condocs/wholesale/wmvct_statement/statement.pdf).

<sup>7</sup> See the CAT's judgment, paragraph 145.

<sup>8</sup> See the CAT's order drawn on 10 March 2006, paragraph 1.

## Section 3

# Introduction

### What this consultation does

3.1 This consultation follows on from the CAT's judgment referred to in the previous sections. 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.<sup>9</sup>

3.2 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.”<sup>10</sup>

3.3 In summarising its findings, 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 noted 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.”<sup>11</sup>

3.4 Accordingly, Ofcom in reconsidering that part of its decision in June 2004 relating to CBP, in light of the CAT's judgment, has done so taking account of the facts that:

- 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 potential competition.<sup>12</sup>

<sup>9</sup> See the CAT's order drawn on 10 March 2006, paragraphs 1 and 2.

<sup>10</sup> Article 14(2) of the Framework Directive. (See [http://europa.eu.int/eurlex/pri/en/oj/dat/2002/l\\_108/l\\_10820020424en00330050.pdf](http://europa.eu.int/eurlex/pri/en/oj/dat/2002/l_108/l_10820020424en00330050.pdf))

<sup>11</sup> See the CAT's judgment, paragraph 23.

<sup>12</sup> None of which were contested by H3G in its appeal.

- 3.5 This document consults on Ofcom's reconsideration of whether H3G has SMP in the market for wholesale voice call termination on its network in light of the CAT's order.
- 3.6 In reconsidering whether BT has sufficient CBP to negate the finding of SMP, Ofcom has looked, in particular, at:
- Any material from the 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 CAT also states in its judgment<sup>13</sup> "that it may well be that circumstances would require a fuller investigation ... of the possibility of joint dominance...". As set out in the third consultation, joint dominance does not appear to be relevant in this situation, since each MNO has 100% market share in the relevant market.
  - Any 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 (the most recent part of this is confidential and is included in Annex 2 of this document); and
  - The effect that any prospect of regulation might have on the degree of CBP held by BT, considering the end-to-end connectivity obligation imposed on BT.<sup>14</sup>
- 3.7 Ofcom has also considered whether the factual circumstances have changed significantly in any respect since its June 2004 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 consultation, December consultation, June 2004 statement, the preliminary consultation, the March consultation and the third consultation.

### Outline of this document

- 3.8 This consultation document should be read in conjunction with Ofcom's June 2004 Statement and its preceding May and December consultations, which set out Ofcom's reasoning in relation to those aspects of its June 2004 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 on that market and therefore no potential competition. The remainder of this document is structured as follows:
- Section 4 assesses whether BT has CBP in purchasing wholesale mobile voice call termination services from H3G, and if so, the extent of its CBP;
  - Section 5 considers whether there have been any changes to the other relevant SMP criteria or factors since the June 2004 Statement;
  - Section 6 sets out the regulatory remedies proposed by Ofcom and contains the Impact Assessment.

<sup>13</sup> See the CAT's judgment, paragraph 141.

<sup>14</sup> See the CAT's judgment, paragraphs 139 and 142.

3.9 Annex 3 contains the Notification under sections 48(2) and 80 of the Act, containing Ofcom's proposals for identifying the relevant market, the making of a market power determination and the setting of SMP services conditions in relation to H3G.

## Section 4

# Assessment of the existence and the extent of BT's countervailing buyer power

- 4.1 Wholesale mobile voice call termination 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. 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 network operators rather than retail customers.
- 4.2 Under the Framework Directive (Directive 2002/21/EC), the European Commission has adopted a Recommendation on relevant products and services markets ('the Recommendation') which identifies markets within the electronic communications sector, the characteristics of which may be such as to justify the imposition of regulatory obligations.<sup>15</sup> If Ofcom considers a market reviewed is not effectively competitive, it may intervene to impose 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.
- 4.3 As mentioned in paragraph 3.2, an undertaking shall be deemed to have significant market power if, either individually or jointly with others, "it 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."
- 4.4 In respect of wholesale mobile voice call termination, where each MNO has a 100% market share in its own termination market, there are no competitors, and the service is only sold to and purchased by other network providers. The SMP test relates to an assessment of the power of the selling operator to behave to an appreciable extent independently of its customers (i.e. other network operators).
- 4.5 For the reasons explained previously, in this section, Ofcom considers whether BT has a degree of CBP in relation to its purchase of wholesale call termination from H3G sufficient so as to counter the prima facie indicators that suggest H3G has SMP.
- 4.6 CBP 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.
- 4.7 Buyer power 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. The Commission notes in its Explanatory Memorandum<sup>16</sup> ('EC Memorandum') to its Recommendation on Market Definition that:

<sup>15</sup> See

[http://europa.eu.int/information\\_society/topics/telecoms/regulatory/maindocs/documents/recomen.pdf](http://europa.eu.int/information_society/topics/telecoms/regulatory/maindocs/documents/recomen.pdf).

<sup>16</sup> Explanatory Memorandum to the Commission 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. (See

“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.”

- 4.8 In considering whether an undertaking has SMP, it is not sufficient just for the buyer to have some CBP but, rather, it is necessary that the buyer can exert sufficient CBP such that the prices charged by the seller are constrained to the competitive level. Any rate above that level would imply that the buyer’s CBP is not sufficient and would therefore imply that that the seller has SMP.
- 4.9 In considering the existence and extent of BT’s buyer power, the following paragraphs:
- revisit the CAT’s conclusions as to the errors made in Ofcom’s June 2004 statement in assessing the existence and extent of BT’s CBP;
  - classify the type of bargaining situation between BT and H3G in respect of mobile wholesale voice call termination;
  - reconsider the criteria against which Ofcom assesses CBP;
  - summarise the regulatory context in which it is appropriate to assess CBP;
  - summarise what the evidence has shown about the history of negotiations between H3G and BT; and
  - set out our assessment of whether BT has had and will continue to have CBP sufficient to counter the prima facie indicators that H3G has SMP.
- 4.10 In order to carry out its assessment, Ofcom sent information requests to both H3G and BT seeking information concerning their strategy for and price negotiations concerning the sale and purchase of wholesale mobile voice call termination services.
- 4.11 Ofcom has conducted its assessment by reference to the evidence provided, in particular evidence concerning:
- The conduct of H3G’s negotiations with BT for interconnection services, leading to the Supplemental Agreement and Pricing letter entered into on 29 January 2002 between H3G and BT, in which the current rate paid by BT for H3G’s services was set, including each party’s internal documents relating to those negotiations;
  - Subsequent negotiations between H3G and BT;
  - The parties’ strategies for interconnection with each other; and
- 

[http://europa.eu.int/information\\_society/policy/ecommerce/doc/info\\_centre/recomm\\_guidelines/relevant\\_markets/en1\\_2003\\_497.pdf](http://europa.eu.int/information_society/policy/ecommerce/doc/info_centre/recomm_guidelines/relevant_markets/en1_2003_497.pdf).)

- Each party's contemporaneous views (as evidenced by their documents) on the likelihood and potential outcome of the resolution of a dispute as to interconnection by Ofcom.

4.12 Ofcom has also relied in this consultation document on evidence submitted by H3G in respect of a hearing of the Competition Commission with H3G ("Mobile Phone Inquiry") dated 8 October 2002. Ofcom has sought and obtained the consent of the Competition Commission and H3G to publish relevant parts of the transcript of this hearing.

### **The CAT's findings concerning Ofcom's assessment of the existence and extent of BT's CBP**

4.13 The CAT's judgment concludes 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."<sup>17</sup>

4.14 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."<sup>18</sup>

4.15 Consequently, the CAT noted that the full factual position must be looked at, including how far regulation will actually operate in any deemed negotiation.<sup>19</sup> In light of the CAT's judgment, in the sections below we will review the regulatory factors relevant to an assessment of CBP, as well as the facts relating to H3G and BT, and then apply these factors in Ofcom's assessment of the existence and extent of BT's CBP.

### **Classification of the type of bargaining situation between H3G and BT in respect of mobile voice call termination**

4.16 The framework within which Ofcom has conducted the CBP analysis is the same as the one proposed by H3G,<sup>20</sup> 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 statement. Ofcom's review of the evidence confirms that it remains appropriate.

<sup>17</sup> See the CAT's judgment, paragraph 145.

<sup>18</sup> See the CAT's judgment, paragraph 118.

<sup>19</sup> See the CAT's judgment, paragraph 142.

<sup>20</sup> 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.



- 4.17 Two papers, one written by D. Harbord and K. Binmore<sup>21</sup> and one by D. Harbord<sup>22</sup> have been submitted by H3G in order to provide their economic perspective on CBP. The first paper contains a generic analysis of CBP as a constraint on monopoly power and describes the negotiations between an incumbent fixed network operator and a new entrant providing mobile voice call termination as a bilateral monopoly. 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.
- 4.18 In paragraphs 4.143 to 4.153 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.

### The criteria for assessing countervailing buyer power

- 4.19 The European Commission's guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communication networks and services<sup>23</sup> explains that one of the criteria relevant to assessing SMP is "the absence of or low countervailing buying power".<sup>24</sup>
- 4.20 The European Commission's Explanatory Memorandum<sup>25</sup> ('EC Memorandum') to its Recommendation on Market Definition sets out that even a 100% market share in itself does not automatically imply that the undertaking in question has SMP. This is because an undertaking's ability to behave independently of customers, competitors and consumers depends, among other things, on the ability of its customers to influence its pricing decisions. In this respect the EC Memorandum notes 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."<sup>26</sup>
- 4.21 The OFT has also set out relevant guidance,<sup>27</sup> 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

<sup>21</sup> '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.

<sup>22</sup> '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.

<sup>23</sup> This document, published in July 2002, is available at:

[http://europa.eu.int/information\\_society/policy/ecom/doc/info\\_centre/recomm\\_guidelines/significant\\_market\\_power/c\\_16520020711en00060031.pdf](http://europa.eu.int/information_society/policy/ecom/doc/info_centre/recomm_guidelines/significant_market_power/c_16520020711en00060031.pdf).

<sup>24</sup> Commission guidelines', paragraph 78.

<sup>25</sup> 'Explanatory Memorandum to the Commission 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. (See [http://europa.eu.int/information\\_society/policy/ecom/doc/info\\_centre/recomm\\_guidelines/relevant\\_markets/en1\\_2003\\_497.pdf](http://europa.eu.int/information_society/policy/ecom/doc/info_centre/recomm_guidelines/relevant_markets/en1_2003_497.pdf).)

<sup>26</sup> Ibid. page 20

<sup>27</sup> Assessment of market power, understanding competition law, OFT, 2004. (See <http://www.of.gov.uk/NR/rdonlyres/A92F91BC-B556-4724-8D2B-7002F6CDEA65/0/oft415.pdf>.)



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'.

4.22 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 enhanced:

- "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)..."<sup>28</sup>

4.23 A further criterion is considered by the ERG, namely factors determining whether the buyer is price sensitive.<sup>29</sup>

"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."

4.24 Finally, in the context of mobile termination of calls delivered by fixed networks, there is a further relevant factor, namely the lack of reciprocity in negotiations over termination between fixed operators and mobile operators. The negotiation between a fixed and a mobile operator is considered to be different from negotiations between mobile operators over voice call termination.

4.25 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 able to make calls to customers on another network, but were unable to receive calls from them. However, rather than bilaterally negotiating their respective termination rates, the fixed operators' termination charges are determined by regulation as set out in Ofcom's determination of market

<sup>28</sup> Ibid. page 24

<sup>29</sup> "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](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), paragraph 11.)

power and setting of SMP conditions in the fixed geographic call termination markets.<sup>30</sup>

- 4.26 In this document, Ofcom determined that BT has SMP in the market for fixed geographic call termination on its own network and is subject to a number of SMP Conditions under which it is required to provide network access (in this case, fixed geographic call termination) on terms, conditions and charges that are fair and reasonable, to base its charges for fixed geographic call termination on efficiently incurred long run incremental costs, and is subject to a last condition which imposes a charge control on BT's fixed geographic call termination charges.
- 4.27 As a result, negotiations between H3G and BT on termination are not reciprocal, in contrast to those between mobile operators since any charge H3G receives for termination of voice calls on its network will not impact the charge BT may be able to levy on the mobile operator for termination on the fixed network. Therefore, any potential buyer power BT may have is limited to the transaction itself and there is no linkage between the charge BT pays for termination on H3G's network and the charge they may be paid by H3G for providing termination on its fixed network.
- 4.28 In sections 4.74 to 4.110 below the criteria to assess CBP as set out by the OFT and the ERG in paragraphs 4.22 to 4.23 and the reciprocity of trade between H3G and BT are considered in turn, under the following general headings:
- BT being well informed about alternative sources of supply and readily able to switch from one supplier to another;
  - BT's ability to self -provide mobile voice call termination on H3G's network;
  - BT as an important outlet for H3G;
  - BT's ability to intensify competition among suppliers;
  - BT as a well-informed and price sensitive buyer;
  - The option not to purchase;
  - The option to delay; and
  - Reciprocity of trade between BT and H3G.

### **The regulatory context in which it is appropriate to assess CBP**

- 4.29 The behaviour of both H3G and BT in the course of negotiations will take account of the regulatory context in which they both operate. However, as the CAT observed:

“...regulation is brought into account in determining CBP, whereas the regulation of H3G is left out of account in looking at its side of the SMP assessment. There is nothing inconsistent in this approach. We have identified the illogicality in allowing a presumption of regulation to a putatively regulated body to operate to determine whether SMP exists. This does not apply to a consideration of CBP where one has

<sup>30</sup> See [http://www.ofcom.org.uk/consult/condocs/narrowband\\_mkt\\_rvw/Eureviewfinala1.pdf](http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/Eureviewfinala1.pdf).

to consider the question of a counter party. In assessing the position of that counterparty it would be illogical not to look at the effect of regulation (and no one has suggested we should not), so OFCOM were quite correct in doing so in this case.”<sup>31</sup>

4.30 Indeed, as regards the relevance of the possibility of regulation on H3G’s conduct, the CAT’s judgment observed 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 unprincipled, position, and we consider them to be wrong. The correct position is as found in the RegTP decision, namely that 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.”<sup>32 33</sup>

4.31 So far as BT’s position is concerned, there are two regulatory factors that are relevant to an assessment of whether BT has CBP, insofar as they affect any bargaining strength BT might otherwise have. These are the fact that:

- BT provides end-to-end connectivity (as confirmed in the statement on imposing an obligation on BT to ensure end-to-end connectivity, but not on whatever terms a provider specifies; and
- in the event that terms and conditions cannot be agreed by negotiation, ultimately a dispute can be referred to Ofcom to resolve.

4.32 These two regulatory factors have changed over time. Their changes over time and the implications of the changes will be discussed in paragraphs 4.36 to 4.57 below.

4.33 As set out above at paragraphs 4.29 and 4.30, the CAT has observed that (a) the possibility of regulation being brought to bear on an undertaking can not be prayed in aid of an undertaking as mitigating against its having SMP; and (b) the effect of regulation on a counter party should be looked at.

4.34 In response to this Ofcom considers that, in examining whether or not its dispute resolution powers result in an operator having CBP, it is not appropriate to consider the effect of such resolution on the undertakings on which the SMP analysis is being carried out. In other words, an undertaking can not be found not to have SMP simply because of the fact that a regulator may exercise its dispute resolution powers. To do so would, in the words of the CAT, be “illogical”.

4.35 However, in the alternative Ofcom sets out how it would resolve disputes in paragraphs 4.111 to 4.135 below.

<sup>31</sup> See the CAT’s judgment, paragraph 142.

<sup>32</sup> See the CAT’s judgment, paragraph 99.

<sup>33</sup> The RegTP decision referred to related to a proposed finding by the German NRA as to whether various German operators had SMP in markets for call termination on their respective networks. The CAT, at paragraphs 95 to 99 of its judgment specifically approved the Commission’s approach that it was appropriate to take account of the existence of a regulatory interconnection obligation on the incumbent FNO, DTAG, but not the effect of regulation on the very parties whose market power was under consideration.

## End-to-end connectivity and Ofcom's Dispute Resolution powers

4.36 Figure 1 below gives an overview of the relevant changes in respect of BT's end-to-end connectivity obligation and Ofcom's dispute resolution powers during the relevant time period of this particular case. In the next paragraphs we will describe these changes.

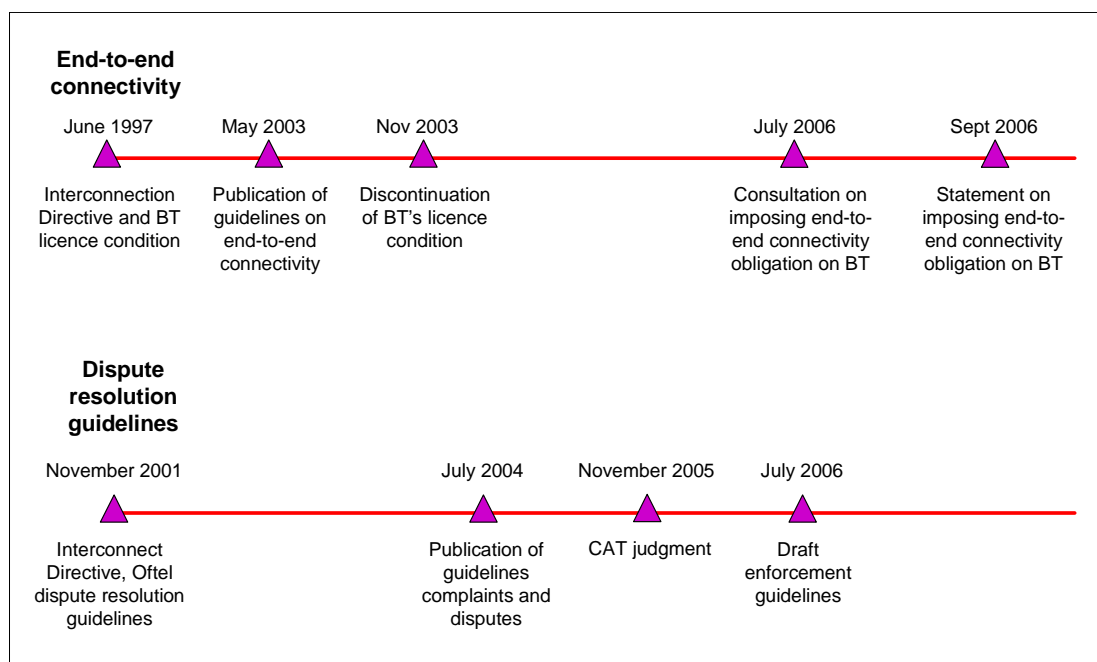


Figure 1: Changes in respect of end-to-end connectivity and dispute resolution changes

### The end-to-end connectivity obligation

- 4.37 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.
- 4.38 It has always been Ofcom's (and previously Oftel's) policy objective to ensure end-to-end connectivity and in order to warrant this, different legal and policy provisions have been introduced over time.
- 4.39 The first relevant time period to this 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, as also set out by the CAT in its judgment.<sup>34</sup>
- 4.40 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).

<sup>34</sup> See the CAT's judgment, paragraph 121.

- 4.41 In case of non-compliance, Oftel would have the ability to intervene under Article 9 of the (now repealed) Interconnection Directive<sup>35</sup> which had been implemented by the (Telecommunications) Interconnection Regulations.<sup>36</sup>
- 4.42 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.<sup>37</sup>
- 4.43 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*.<sup>38</sup> 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.”<sup>39</sup>
- 4.44 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.<sup>40</sup>
- 4.45 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 Directive.<sup>41</sup> However, as set out in the statement on End-to-end connectivity,<sup>42</sup> 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.
- 4.46 Ofcom proposed to remedy this situation by imposing an obligation on BT in order to ensure end-to-end connectivity. Today, the statement entitled *End-to-end connectivity* has been published which 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.
- 4.47 The access-related condition requires BT:
- To purchase wholesale narrowband (fixed and mobile voice and narrowband data) call termination services from any provider of public electronic communications

<sup>35</sup> See OJ No L199/32, 26 July 1997.

<sup>36</sup> <http://www.opsi.gov.uk/si/si1997/19972931.htm>

<sup>37</sup> See for example

[http://www.ofcom.org.uk/consult/condocs/narrowband\\_mkt\\_rvw/nwe/fixednarrowbandstatement.pdf](http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/fixednarrowbandstatement.pdf).

<sup>38</sup> This document is available at:

[http://www.ofcom.org.uk/static/archive/oftel/publications/eu\\_directives/2003/endcon0503.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/endcon0503.htm).

<sup>39</sup> Ibid, paragraph 2.10.

<sup>40</sup> Ibid, paragraph 2.16.

<sup>41</sup> Ibid, paragraph 2.8.

<sup>42</sup> See Ofcom Statement 'End to end connectivity', published on 13 September 2006,

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

networks ('PECN') that reasonably requests in writing that BT purchases such services;

- To ensure that the purchase of such 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.

### **Ofcom's dispute resolution powers**

4.48 Before the new regulatory framework came into force in July 2003, Oftel was required, at the request of either party to an interconnection dispute, to take steps to resolve such a dispute within six months of the request. Article 9(5) of the Interconnection Directive was transposed into national law by paragraphs (6) and (8) of Regulation 6, as well as Regulation 8(3) of the Interconnection Regulations.

4.49 Oftel could, when resolving a dispute, impose obligations under Article 6(6) of the Interconnection Regulations on operators that had not been designated as having SMP.

4.50 In the light of that legal and regulatory framework, Oftel published in November 2001 guidelines on its approach to dispute resolution entitled *Requesting the Director General of Telecommunications to resolve an interconnection dispute: guidance for the telecommunications industry* ('the 2001 Dispute Resolution Guidelines').<sup>43</sup> In those guidelines, Oftel set out, in paragraphs 3.1 and 3.2 that:

"3.1 Operators may fail to reach agreement on an interconnection matter at a number of different points in time. These may include, for example, the initial request to connect networks, the time of a periodic review under a Review Clause of an existing agreement, when an operator wishes to launch a new service or gain access to different parts of another operator's network, or when major change occurs (such as a change in law or a party's licence is modified) which an operator considers is sufficient to warrant a review of existing agreed terms and conditions.

3.2 Some interconnect agreements specify that the right to refer a disputed matter to the Director General may only occur at a specified time. However, an operator's right to seek the Regulator's intervention as set in the Interconnection Regulations is absolute and cannot be limited or overridden by details agreed in commercial contracts."

4.51 In relation to the procedure of resolving a dispute, Oftel explained in paragraph 4.9 that "it should be noted that, although resolution of a dispute can take several months, Oftel may backdate the effect of the direction in those cases where it is considered appropriate and possible."

<sup>43</sup> See [http://www.ofcom.org.uk/static/archive/oftel/publications/ind\\_guidelines/disp1101.pdf](http://www.ofcom.org.uk/static/archive/oftel/publications/ind_guidelines/disp1101.pdf).

4.52 In July 2004, after the new regulatory framework had come into force, Ofcom published new dispute resolution guidelines which stated that:<sup>44</sup>

“Where a dispute arises between parties without SMP, the case for regulatory intervention is not as strong [as where SMP exists]. When Ofcom considers whether it is appropriate for Ofcom to resolve a dispute, Ofcom will therefore consider the market position of the parties. Where market power is unequal, there may be a disincentive on one party to reach a solution and regulatory intervention may be appropriate.”

4.53 These guidelines should not be read as suggesting that Ofcom’s powers and duties in resolving a dispute might be fettered where it concerns parties without SMP. They reflect Ofcom’s view, known to the parties, that its approach to the resolution of an interconnection dispute is likely to be different in cases where the parties do not have SMP, as compared to its likely intervention in cases where one of the parties is considered to have SMP.

4.54 However, in the June 2004 statement,<sup>45</sup> and also during the CAT appeal,<sup>46</sup> Ofcom took the view that it did not have the power to determine the price of an interconnection service in a dispute between two non-SMP parties unless it had first made an SMP decision in relation to the price setting party.

4.55 In its judgment of 29 November 2005, the CAT rejected this view. Its view is that “nothing in the wording of the Act suggests that SMP had to be found before the regulator decided a dispute over price”. It then goes on to explain that:

“Under the Access Directive the NRAs have at least two sorts of powers. The first are powers to ensure end-to-end connectivity; the second are powers to intervene where SMP has been found. A power to determine a dispute as to connection is capable of falling within both, so it is certainly capable of falling within the former.”<sup>47</sup>

4.56 In general, Ofcom’s dispute resolution powers and duties, set out in sections 185 to 191 of the Act, would ultimately require it to resolve a dispute.

4.57 On 6 July 2006 Ofcom published a consultation entitled *Draft Enforcement Guidelines* and is currently consulting on these guidelines until 14 September 2006.<sup>48</sup> These guidelines set out Ofcom’s approach to handling complaints and disputes, and the procedures Ofcom uses in conducting investigations and resolving disputes.

### **The negotiations between H3G and BT**

4.58 In accordance with the CAT’s judgment<sup>49</sup>, Ofcom has considered the factual evidence relating to the negotiations between H3G and BT, in the period of negotiations leading up to the Initial Agreement, and taking account of events following this agreement. These negotiations and other developments took place in 2001-2002 and therefore predate the review period of this assessment, which begins

<sup>44</sup> See [http://www.ofcom.org.uk/bulletins/eu\\_directives/guidelines.pdf](http://www.ofcom.org.uk/bulletins/eu_directives/guidelines.pdf), paragraph 70.

<sup>45</sup> See June 2004 Statement, paragraph 4.14.

<sup>46</sup> See the CAT’s judgment, paragraph 129.

<sup>47</sup> See the CAT’s judgment, paragraph 131.

<sup>48</sup> See <http://www.ofcom.org.uk/consult/condocs/enforcement/enforcement.pdf>.

<sup>49</sup> E.g. CAT judgment, paragraph 142.



in June 2004. We have taken account of these events only to the extent that they indicate how future negotiations on pricing might develop.

### **Negotiations leading to the Initial Agreement between H3G and BT**

4.59 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. Ofcom has, in the course of its review, seen further material submitted by both parties under Section 135 requests by Ofcom, that relate to this period. A summary of events is set out in Annex 1. 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;
- 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.

4.60 The CAT's judgment makes a number of observations regarding this period, based on its review of the evidence:<sup>50</sup>

- 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.

<sup>50</sup> See the CAT's judgment, paragraph 81.



- 4.61 Although some of the evidence<sup>51</sup> shows that BT was aware of H3G's sensitivity to delay, Ofcom's 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.
- 4.62 Ofcom's review of evidence<sup>52</sup> 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.

### Post agreement events

- 4.63 During the course of the CAT proceedings, H3G had argued that the interim price agreed between H3G and BT was "embedded"<sup>53</sup> and submitted evidence from H3G's then regulatory director that H3G was constrained from seeking to terminate the agreement or renegotiate the termination charge.<sup>54</sup>
- 4.64 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.<sup>55</sup> 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.
- 4.65 Further evidence provided to Ofcom 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.
- 4.66 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.<sup>56</sup> BT noted that H3G was free to propose changes in tariffs at any point in time, by issuing an Operator Charge Change Notice

<sup>51</sup> Email exchange between BT and H3G dated 3 December 2001

<sup>52</sup> 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.

<sup>53</sup> See the CAT's judgment, paragraph 84.

<sup>54</sup> See the CAT's judgment, paragraph 85.

<sup>55</sup> See the CAT's judgment, paragraph 84.

<sup>56</sup> Internal BT email dated 4 April 2002.

(OCCN). The minutes of the meeting on 26 March 2002<sup>57</sup> 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."

- 4.67 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 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."

- 4.68 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.
- 4.69 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. Oftel implemented the recommended reductions by July 2003 and following the market review

<sup>57</sup> As attached to an internal H3G email, dated 9 May 2002.

completed in June 2004, imposed further reductions on the 2G termination charges of Vodafone, Orange, O2 and T-Mobile.

- 4.70 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.
- 4.71 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."<sup>58</sup>

- 4.72 H3G launched its service using the One2One set of prices (fm3) in 2003. At that time, One2One 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 2 below, H3G's termination rate is currently significantly higher than those of the other MNOs.

	Daytime	Evening	Weekend
O2	6.373	6.310	3.140
Orange	7.601	5.447	4.354
T-Mobile	8.146	4.000	4.000
H3G	15.620	10.78	2.510
Vodafone (blended 2G – 3G charge)	8.500	3.450	2.830

Figure 2: Wholesale termination charges at 30 March 2006, ppm

- 4.73 Annex 2 to this consultation 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 or other terms and conditions of the interconnection contract between H3G and BT.

<sup>58</sup> Transcript of H3G's hearing at the Competition Commission in the context of the 'Mobile Phone Inquiry', 8 October 2002, page 9 and 10.

## Assessment of BT's countervailing buyer power

- 4.74 In sections 4.19 to 4.28 above, we have set out the relevant criteria for assessing CBP. In this section we consider, in light of these criteria and by reference to the evidence, the relative bargaining strengths of BT and H3G, taking account of the implications over time of BT's end-to-end connectivity obligation and of Ofcom's dispute resolution powers and duties to resolve interconnection disputes. This section assesses the extent to which BT can exert sufficient negotiating power to constrain H3G's presumption of SMP.
- 4.75 In this context, the test to assess whether H3G's presumption of SMP is sufficiently constrained would be to analyse whether BT's buyer power could constrain H3G's termination rate to the competitive price level. Any rate above that level would imply that BT's CBP is not sufficient and would therefore imply that H3G has SMP.
- 4.76 As discussed above, this assessment covers the period from June 2004 to 31 March 2007. It includes a review of available evidence prior to the establishment of the interconnection agreement in January 2002 in order to identify factors which remain relevant in undertaking the assessment of the extent to which BT can exert CBP in the relevant period. From the evidence it is clear that the balance of the relationship between BT and H3G has evolved over time, for example as H3G has grown and become more established. Furthermore, with the establishment of the original interconnection agreement, H3G is not as sensitive to delay as it was before the agreement was established. Ofcom makes its assessment in relation to the relationship as it existed and is likely to continue during the period of this review.

### **BT being well informed about alternative sources of supply and readily able to switch from one supplier to another, BT's ability to self-provide mobile voice call termination on H3G's network and BT's ability to intensify competition among suppliers**

- 4.77 As noted in paragraph 3.3 above, H3G has a 100% market share in the market under consideration and there are absolute barriers to entry to that market. In its June 2004 Statement, Ofcom, in arriving at its conclusions on market definition, considered that:

“no adequate wholesale supply or demand side substitutes for termination of calls to the subscribers of a specific MNO currently exist. Current technology does not allow the termination of a call to a mobile other than on the network of the MNO to which the called party subscribes. This appears unlikely to change in the near future. At the retail level, Ofcom is of the view that, at present, there are no effective alternatives for callers that could act as a constraint on termination charges ... Technological conditions and the behaviour of called and calling parties may change over time, but Ofcom believes that this is extremely unlikely to happen in the next two to three years.”

- 4.78 Looking from June 2004 to the present, it is clear that no supply or demand side substitutes have emerged. This point of view is reiterated in the third consultation which was published today. For the reasons set out in June 2004 and in the third consultation, Ofcom considers that this position is unlikely to change in the period to April 2007.

- 4.79 Based on the fact that H3G has a 100% market share in the market under consideration and that there are absolute barriers to entry, BT cannot bring to bear CBP by changing to another supplier, by self-providing mobile voice call termination on H3G's network or by intensifying competition among suppliers.

### **BT as an important outlet for H3G**

- 4.80 As explained in section 4.22 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.
- 4.81 BT is, and at all times has been, an important customer for H3G. Ofcom estimates in the third 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.
- 4.82 H3G's customer base has grown substantially over time. According to a press release on H3G's own website, dated 10 May 2006, H3G at that point in time had over 3.5 million subscribers whereas in March 2004 its customer base was estimated to be between 384,300 and 420,000.<sup>59</sup> 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.
- 4.83 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 any trend towards direct interconnection which would reduce the need to use BT as a transit operator.
- 4.84 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 38% in Q1 2004 to 42% 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.
- 4.85 The only MNO which currently interconnects directly with H3G is O2. This is a consequence of a national roaming agreement entered into at the time of H3G's launch, which was intended to allow H3G coverage in those areas where its network was not complete. However, H3G has recently announced that from the end of 2006 onwards, Orange too will provide national roaming to H3G and it is conceivable that Orange may then deliver calls directly to H3G without the use of BT transit (although this is not known). If the interconnection agreement between O2 and H3G stays in place, this would mean that one additional MNO may interconnect directly with H3G, resulting in a decrease of transit traffic via BT.
- 4.86 Except for BT, no other fixed operator interconnects directly with H3G. The other FNOs all use BT to transit calls bound for H3G subscribers.

<sup>59</sup> See June 2004 Statement, paragraph 5.29.

- 4.87 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;
  - BT's charge for transit;
  - The termination charge the originating operator agrees with the terminating MNO; and
  - The costs associated with establishing direct interconnection.
- 4.88 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.
- 4.89 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, if 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, taken into account the size of BT's customer base, Ofcom considers BT will remain an important customer for H3G for the period until March 2007.

### **BT as a well-informed and price sensitive buyer**

- 4.90 It may reasonably be assumed that BT is a well informed and price sensitive buyer with extensive commercial expertise. Over time, BT has established a large number of interconnection contracts with both fixed and mobile operators and will have built up a vast amount of experience in terms of negotiating terms and conditions of interconnection contracts. It will be 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.
- 4.91 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, it is likely to become increasingly sensitive to the price it pays for that service.
- 4.92 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.
- 4.93 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”.<sup>60</sup>
- 4.94 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.
- 4.95 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 will have had and will continue to have an incentive to negotiate competitive prices with H3G. It is noted, however, that as H3G has become a more important supplier, BT’s bargaining power in its negotiations is likely to be reduced. More importantly, given that H3G is the only supplier, BT’s only 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:
- The ability and incentives for one party to threaten to boycott the other party temporarily and stop purchasing call termination;
  - The ability and incentives for one party to delay an agreement with the other party; and
  - Ofcom’s actions in the event a dispute is brought to it.

### **The option to boycott and not to purchase**

- 4.96 As set out in paragraphs 4.37 to 4.47 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.
- 4.97 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

<sup>60</sup> Email from BT to H3G dated 3 December 2001.

customers.<sup>61</sup> It therefore had an incentive to purchase call termination services from H3G.

- 4.98 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 would have referred this issue as a dispute to previously Oftel and now Ofcom. As H3G now had interconnection in place it was no longer sensitive to delay. Oftel or Ofcom in this case 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 warrant end-to-end connectivity.
- 4.99 Therefore, from May 2003 until September 2006, BT could not and did not credibly threaten not to purchase H3G's services on reasonable terms and conditions.
- 4.100 From 7th September 2006 onwards, BT has an end-to-end connectivity obligation; BT cannot credibly threaten not to purchase H3G's services on reasonable terms and conditions.
- 4.101 Whilst, as set out above, BT does not have the option to simply refuse to interconnect, it is not required to do so on whatever terms a provider specifies.<sup>62</sup> In the event that terms cannot be agreed between the parties, either party may refer the matter to Ofcom for resolution. Furthermore, the agreement to physically interconnect between H3G and BT is subject to a two year notice period on termination, in which both parties are obliged to seek a new agreement for interconnection, with the aim of concluding a new agreement before termination of the previous agreement. In that period, it would be expected that any dispute between the parties could be referred to Ofcom as a dispute. Therefore it is necessary to consider the likely effect of dispute resolution by Ofcom. This is discussed in paragraphs 4.111 to 4.135 below.
- 4.102 As a result, the threat not to purchase voice call termination from H3G does not appear to be credible at any point in time during the period under consideration. 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 very 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. On this basis the evidence appears to support the view that BT did not and does not consider a refusal to buy termination as a viable option for its business, albeit on reasonable terms and conditions.

### **The option to delay**

- 4.103 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.
- 4.104 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

<sup>61</sup> WPAG paper "Proposed termination rates for calls to H3G's mobile services", attached to internal BT email dated 10 January 2002.

<sup>62</sup> See the CAT's judgment, paragraph 125.



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.<sup>63</sup> While, as the CAT recognised, it does not appear that BT aggressively sought to exploit the risks of delay to H3G,<sup>64</sup> it is possible that this factor may, at that time, have affected the overall balance of negotiating power between the parties.

- 4.105 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 be not a delay of the purchase of services, but a referral of a dispute to Ofcom. In paragraphs 4.111 to 4.135 below, Ofcom sets 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.
- 4.106 Thus, 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.

### **Reciprocity of trade between BT and H3G**

- 4.107 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 80% of fixed network subscribers, 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.
- 4.108 However, as set out above, BT's termination rate is determined by regulation and, 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 wholesale mobile voice call termination on its network and cannot therefore be considered to be a source of BT's bargaining strength.
- 4.109 In this specific case, where BT sells other services, for instance leased lines to H3G, 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.
- 4.110 In summary, the assessment of BT's CBP based on the relevant criteria and in light of the evidence shows that:

<sup>63</sup> 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".

<sup>64</sup> See the CAT's judgment, paragraph 81.

- BT cannot bring to bear CBP by changing to another supplier, by self-providing mobile voice call termination on H3G's network or by intensifying competition among suppliers;
- BT has been and will continue to be an important customer to H3G;
- BT can be considered to be a well-informed and price sensitive purchaser of H3G's mobile voice call termination;
- From May 2003 until September 2006 and from September 2006 onwards, BT could not and did not credibly threaten not to purchase H3G's services on reasonable terms and conditions;
- Delay may have been an effective strategy for BT prior to the negotiation of the initial agreement in January 2002, when BT may have been able to exploit H3G's sensitivity to delay interconnection. However, there is no evidence that BT has ever delayed the negotiation process. However, with an interconnection agreement in place between BT and H3G there no longer is significant asymmetry between the parties in respect of their sensitivity to delay.
- Because fixed termination rates are subject to regulation, the price BT charges H3G for termination on BT's network cannot influence the negotiations of the price H3G charges BT for wholesale mobile voice call termination on its network and cannot therefore be considered to be a source of BT's bargaining strength.

### **Ofcom's dispute resolution powers in the context of end-to-end connectivity**

4.111 Ofcom considers that its dispute resolution powers in the context of end-to-end connectivity are an important factor in assessing whether H3G has SMP. As set out by the European Commission at paragraph 22 of its veto of a notified draft measure by the German Regulator, RegTP, requiring it to withdraw its notification on the fixed call termination market that 53 Communications Providers, apart from Deutsche Telekom AG (DTAG), did not have SMP.<sup>65</sup>

“On the basis of competition rules, applicable under Article 14 and 16 of the Framework Directive, in particular Article 82 of the EC Treaty, an analysis of dominance (i.e. SMP) requires taking into account the concrete economic circumstances including legislative and administrative acts. In economic terms, it is not appropriate to exclude regulatory obligations that exist independently of a SMP finding on the market under consideration but that can have an impact on the SMP finding on the markets under consideration. From a methodological viewpoint obligations flowing from existing regulation, other than the specific regulation imposed on the basis of SMP status in the analysed market, must be taken into consideration when assessing the ability of an undertaking to behave independently of its competitors and customers on that market. In the Commission's view, this could only be otherwise where it is uncertain whether the regulation concerned will continue to exist throughout the period of the forward looking assessment.”

<sup>65</sup> Commission Decision of 17 May 2005, Case DE/2005/0144, C(2005) 1442 final, paragraph 22.

- 4.112 The effectiveness of any threat to refer a dispute to Ofcom in achieving lower charges for BT, or higher charges for H3G, may have an important bearing on the likely outcome of any negotiations on charges between H3G and BT. This is because, if both parties have a reasonable expectation of a specific outcome of a dispute, this expectation will shape any negotiation and agreement on charges, even absent any intervention by Ofcom. Furthermore, the negotiated outcome could approximate to the expected outcome of a dispute resolved by Ofcom in certain circumstances, because both parties know that the other will have an incentive to refer if it considers that it has something to gain from so doing.
- 4.113 Therefore, set out below is Ofcom's view of the parties' expectations as to how previously Oftel or now Ofcom might resolve a dispute in the context of end-to-end connectivity over time.
- 4.114 Prior to the coming into force of the new regulatory framework and at the time of the establishment of the agreement with H3G, BT was under the obligation to provide end-to-end connectivity by reference to its Licence Condition 45 (see paragraphs 4.39 and 4.40 above).
- 4.115 The relevant dispute resolution guidelines at that time were the 2001 Dispute Resolution Guidelines.
- 4.116 Although these guidelines to resolve an interconnection dispute specifically mention the possibility of imposing obligations on non-SMP-operators and backdating the effect of any direction taken where appropriate,<sup>66</sup> Ofcom found no evidence as to whether or not BT believed in the past that dispute resolution would lead to an outcome it considered more favourable than it could achieve through negotiations.
- 4.117 BT was under an obligation to provide end-to-end connectivity and, as evidenced in an internal BT paper,<sup>67</sup> BT had very little information about the underlying costs of termination on H3G's network :

"H3G has stated, at this time, it is unable to provide cost information in support of the proposed termination rates as it is still in the early stages of provisioning its network. Even if additional information was to be obtained it is uncertain that we would be in a position to judge the reasonableness of such data."

- 4.118 If BT had deemed the price for termination to be unreasonable, it could have referred a dispute to Ofcom. However, it would have considered it difficult to arrive at a realistic assessment as to the reasonableness of any price proposed by H3G and hence whether there was merit in referring a dispute to Oftel.
- 4.119 H3G, on the other hand, was concerned that intervention by Oftel would lead to a lengthy process which could potentially delay its launch. The evidence shows that BT was aware of H3G's sensitivity to delay, but – as noted above at paragraph 4.60 Ofcom has found there is no evidence to suggest that BT used this information to its advantage by delaying, or threatening to do so, in order to negotiate a lower charge.

<sup>66</sup> Under the old regulatory regime, the test for SMP was a market share of 25% in the relevant market, as set out in Section 4.3 of the Interconnection Directive.

<sup>67</sup> 'Proposed termination rates for calls to Hutchison 3G's mobile services' paragraph 5.2, dated January 2002.

4.120 Indeed, this is reflected in H3G's comments in October 2001:<sup>68</sup> when asked by the Competition Commission what H3G thought Oftel would do if it were to refer a dispute to Oftel, H3G replied that their external legal advice had been that:

“once there is a referral to Oftel, it will turn into Oftel having to make a decision about what your voice termination should be. That might be the only way they can fulfil their role’. When asked by the Competition Commission whether Oftel had actually said what it would do, H3G replied that Oftel had not been that specific.”

4.121 Therefore, based on the available evidence, at that time, both parties were uncertain as to how Oftel would resolve a dispute and preferred to negotiate a termination rate.

4.122 After the agreement was established, the time constraint on H3G no longer exists. Therefore, the prospect of dispute referral is no longer a matter of concern to H3G in that regard. This is clearly illustrated by evidence given by H3G to the Competition Commission. H3G was asked whether it would respond differently, in the event that BT were to seek to put pressure on H3G to reduce its termination rates in line with other operators, depending on whether an arrangement had already been established or not. H3G's then regulatory director explained :

“Yes, because we would have an existing arrangement in place. The problem we had in the initial negotiation process was that we have no arrangement for interconnection which we are required to have for our licence in order to launch. This is the fundamental difference.”<sup>69</sup>

4.123 In the period since the establishment of the original agreement, H3G is therefore no longer affected by the potential delay caused by the referral of a dispute. BT potentially could gain by threatening to refer a dispute to Ofcom on the grounds that H3G's actual or proposed termination charge is unreasonable but again, since the establishment of the original agreement BT has never referred a dispute to Ofcom.

4.124 As described in sections 4.36 to 4.57 above, a significant number of changes in the regulatory framework in the context of end-to-end connectivity and dispute resolution have taken place since the original agreement between H3G and BT was established. However, we have very little evidence that the expectations of either party has changed subject to changes in the regulatory framework, other than the time constraint not being a matter of concern for H3G anymore. Neither BT nor H3G has referred a dispute to Oftel or Ofcom, and nothing in the evidence indicates that either party has seriously considered doing so.

4.125 In sections 4.37 to 4.47 above, we have set out BT's end-to-end connectivity requirements under the different relevant regulatory frameworks. As pointed out there, from 7 September 2006 onwards, BT's end-to-end connectivity obligation requires BT to purchase termination from H3G if offered on reasonable terms and conditions (including charges). If the obligation on BT to purchase termination were absolute, BT would not have any countervailing buyer power at all; however, this is not the case given that termination has to be offered by H3G on *reasonable* terms and conditions.

<sup>68</sup> Transcript of Competition Commission hearing on 8 October 2002, page 28.

<sup>69</sup> Transcript of Competition Commission hearing on 8 October 2002, page 25.

- 4.126 This said, if BT does not consider the terms and conditions offered by H3G for termination to be reasonable, it can refer a dispute to Ofcom if it thought that it would obtain more favourable terms and conditions, including lower charges.
- 4.127 As a result, it is important to consider how Ofcom might resolve a dispute. In the exercise of its dispute resolution powers, described below, Ofcom will consider each dispute on its merits, and may employ a number of alternative methodologies to assess what might be an appropriate price for wholesale mobile voice call termination on H3G's network.
- 4.128 In this context, any regulatory action Ofcom takes has to reflect the fact that, as set out in the proposed end-to-end connectivity condition, BT has to purchase termination on reasonable terms and conditions. Furthermore, any intervention by Ofcom has to be appropriate and proportionate to remedy the issues identified. Depending on the dispute, possible outcomes might be that Ofcom:
- considers whether alternative dispute resolution (ADR) is an option;
  - upholds the charge proposed by H3G/BT so long as it is not unreasonable;
  - develops an understanding of the extent to which BT and H3G would generate net gains from trade, imposing an outcome that shares these gains on some basis between the parties to the dispute; or
  - undertakes a benchmarking exercise of relevant comparators and draws conclusions as to an appropriate termination charge based on those benchmarks.
- 4.129 Ofcom notes that this list of outcomes is not exhaustive. The above illustrates that Ofcom has a broad range of options at its disposal should it be required to intervene to resolve a dispute between BT and H3G in the context of end-to-end connectivity and that there is no certainty as to the outcome of the dispute resolution.
- 4.130 As set out in paragraph 4.75 above, in order to assess whether BT's ability to refer a dispute in the context of end-to-end connectivity means it has sufficient CBP, a relevant question is whether a dispute resolved by Ofcom between H3G and BT in the context of the end-to-end connectivity obligation would result in a termination rate at the competitive price level. Any rate above that level would imply that BT's CBP is not sufficient to prevent H3G from raising prices above that level and would therefore imply H3G has SMP.
- 4.131 The key underlying objective of resolving a dispute in this context would be to set a level appropriate to ensure the provision of end-to-end connectivity based on the facts of any dispute. (Based on the wording in Article 5 (1) (a) of the Access Directive, which sections 73, 74 of the Communications Act 2003 seek to implement.)<sup>70</sup> Therefore, the focus of Ofcom's intervention would be to prevent the charges from leading to a lack of such connectivity, not to reduce the charges to the competitive level.
- 4.132 The statement on End-to-end connectivity reflects this view. It explains that BT is not obliged to purchase wholesale narrowband call termination services at any price, but to do so where requested by a PECN and where the terms and conditions offered by that PECN are reasonable. Whether a particular term or condition (including charge) is reasonable will depend on the particular circumstances relating to any decision not

<sup>70</sup> See [http://www.ofcom.org.uk/consult/condocs/end\\_to\\_end/end2end.pdf](http://www.ofcom.org.uk/consult/condocs/end_to_end/end2end.pdf).

to purchase in the context of the need to ensure end-to-end connectivity and may lie within a broader range of outcomes than that which might be considered in the circumstances of SMP. In particular, as Ofcom has to ensure that any charges it imposes are proportionate, it is unlikely to set charges at the competitive price level.

- 4.133 The proxy for the competitive price level in the last MCT market review was a strict cost orientated charge based on LRIC plus mark-ups for common cost and externality. Only in this case is the purchaser able to exercise sufficient CBP through the threat of referring a dispute to Ofcom.
- 4.134 Ofcom, in determining a charge as part of a dispute based on BT's end-to-end connectivity obligation, would have to strike the appropriate and proportionate balance between the expected benefits of its intervention, such as ensuring end-to-end connectivity in this case, and the expected costs, such as the risk of disincentivising investment by being overly interventionist in forcing down charges too far. As mentioned in paragraph 4.131 above, the objective of dispute resolution in this case would be to ensure end-to-end connectivity, and this, and the absence of significant market power is relevant to the way in which this balance between costs and benefits would be struck.
- 4.135 Therefore, from June 2004, even if BT did refer a dispute to Ofcom on the basis that the charges are not reasonable in the context of its end-to-end connectivity obligation, it couldn't rely on dispute resolution to constrain H3G's prices to the competitive level, and therefore, any CBP BT has would not be sufficient to prevent H3G from raising the charges above the competitive price level.

### **The extent of BT's negotiating power as evidenced by the commercial negotiations and subsequent developments**

- 4.136 The overall picture that emerges in the period prior to the initial agreement between H3G and BT makes it apparent that, during that period, BT held some negotiating power, arising principally from the time pressure under which H3G was then placed to establish an interconnection agreement with BT. A threat of referring a dispute to Oftel was a means by which BT may have been able to exert its negotiating power against H3G, because of the implications that a dispute resolution process would have had in delaying the conclusion of an agreement between H3G and BT.
- 4.137 However, for the reasons discussed above, those elements from which BT's negotiating power derived do not persist into the period from June 2004 to March 2007, to which this review relates.
- 4.138 Throughout the period leading up to the Initial Agreement, both parties had proceeded on the understanding that following the agreement of the "interim" price, a final "launch" price would be agreed for H3G's services. The evidence shows that a further negotiation relating to a launch price began in March 2002. However, as set out in paragraphs 4.65 and 4.66 above, it is apparent that the decision not to proceed with an altered launch price was taken by H3G for two reasons:
- The regulatory climate had changed in that the termination charges of other MNOs were the subject of a Competition Commission inquiry. In that climate, H3G was concerned it would not be able to achieve higher termination charges;

- H3G had changed its business plan and assumed that termination rates would no longer reduce each year.<sup>71</sup>
- 4.139 The failure to agree a different “final” termination charge appears to be unrelated to the exercise of any negotiating power by BT and does not therefore suggest that BT exerted CBP.
- 4.140 The Competition Commission’s inquiry resulted in significant reductions in the 2G termination charges of MNOs other than H3G. At the time of the inquiry, H3G had been concerned that such reductions in termination charges of others would, indirectly, lead to reductions in its own termination charges. H3G’s evidence to the Competition Commission in 2002 suggested that its expectation was that it would not be able to sustain termination charges substantially different from those of other networks, at least in part as a result of pressure from BT. Internal H3G documents on voice call interconnect<sup>72</sup> however suggest H3G had changed its business plan and assumed that termination rates would no longer reduce each year.
- 4.141 Although the termination charges of the other MNOs have fallen sharply, H3G has succeeded in maintaining its charges at the level agreed in 2002, as shown in Section 4.70 above. Consequently, H3G’s termination charges are currently significantly higher than those of other MNOs.
- 4.142 Ofcom does not anticipate that the balance of negotiating power between H3G and BT will change significantly in favour of BT looking forward to March 2007. Indeed, as noted in paragraphs 4.89 above, to the extent that factual circumstances may change, they are likely to enhance H3G’s position as H3G’s customer base continues to grow.

### **Review of the evidence in the context of the economic framework**

- 4.143 As mentioned in paragraph 4.16 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. 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.
- 4.144 Ofcom notes that, in its analysis of BT’s CBP, Ofcom has confirmed that the context within which negotiations between H3G and BT for mobile voice call termination on H3G’s network have been taking place is appropriately characterised as a bilateral monopoly framework. Such a characterisation of the negotiations is also justified on the basis of the facts underlying this specific case.
- 4.145 Binmore and Harbord’s model predicts that incumbent fixed network operators 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).<sup>73</sup>

<sup>71</sup> Internal paper entitled “Voice call interconnect: wholesale charging strategy” attached to internal H3G email, dated 9 May 2002.

<sup>72</sup> Ibid.

<sup>73</sup> “Bargaining over Fixed-to-Mobile Termination Rates: Countervailing Buyer Power as a Constraint on Monopoly Power”, published in *Journal of Competition Law and Economics*.

- 4.146 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.<sup>74</sup>
- 4.147 Critical to the results of Binmore and Harbord's model are the assumptions as to how Ofcom would resolve a referred dispute. These assumptions are in Ofcom's view incorrect, as Harbord and Binmore assume that the regulator would either set a charge based on the average 2G rates, or would enforce it to set a strictly cost based charge.
- 4.148 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 in paragraphs 4.111 to 4.135 where it was set out how Ofcom might resolve a dispute in the context of end-to-end connectivity, Ofcom stated that it has a broad range of options and that it is unlikely to set charges at a level set in the context of an SMP review.
- 4.149 Finally, 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.
- 4.150 From the evidence before it, Ofcom has concluded 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.
- 4.151 Further, whilst Ofcom has seen no 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.
- 4.152 However, the relative bargaining positions of the two parties – and hence the likely outcome of the analysis – change significantly once an Initial Agreement has been reached and both parties have a sizable customer base. In particular, once the initial termination agreement and charges were in place, there is no longer significant asymmetry in the cost of delay between the parties because interconnection is guaranteed and each party could issue an OCCN to request for a change in termination rates; 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 they were hopeful that a reasonable commercial solution could be reached.<sup>75</sup>
- 4.153 In summary, following the establishment of the Initial Agreement, both H3G and BT have a clear commercial incentive to remain interconnected. While H3G's bargaining power may be limited by the importance of BT as a customer, BT's bargaining power is limited by its obligation to purchase and its commercial incentives to do so. Both BT and H3G could issue an OCCN and enter into price negotiations and, in the event

<sup>74</sup> As regards the assumptions relevant to the parties' incentives, Binmore and Harbord consider the factors of market saturation and negative externalities, which may reduce the incentives of the incumbent to come to an agreement. Although it is noted that the evidence provided by the parties has not validated these assumptions, Ofcom recognises that there may indeed be other reasons why BT – on a purely commercial basis – may have incentives to negotiate forcefully. This is explored in detail in the sections on the importance of BT as a buyer to H3G, and on BT's likely price sensitivity as a buyer.

<sup>75</sup> Letter from H3G to Ofcom, dated 21 January 2002



that no agreement is reached, either party could refer a dispute to Ofcom. Harbord and Binmore erroneously assume that the outcome of such a process would yield charges at cost or at the level of charges of the 2G operators. But Ofcom has explained that this is unlikely to be the case. 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 is incorrect.

### **Initial conclusion on CBP**

- 4.154 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. Taking into account the evidence prior to the establishment over the original interconnect agreement between H3G and BT, over the period from June 2004 looking forward to 31 March 2007, BT is not and is unlikely over the period of assessment to be able to exert CBP through a threat either to purchase the service from an alternative source or to self-supply.
- 4.155 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. In the time period from July 2003 to September 2006, BT could not realistically have constrained the price it must pay H3G by credibly threatening to delay an OCCN aimed at establishing a higher price or to cease purchasing termination from H3G. Both the delay of an OCCN and a refusal to purchase termination would probably have resulted in H3G referring a dispute to Ofcom. In this context, neither party would have certainty as to the outcome of dispute resolution by Ofcom. However, for the reasons set out above, Ofcom's intervention in such a case would have been unlikely to result in charges at the competitive level.
- 4.156 From September 2006 onwards, BT has an end-to-end connectivity obligation and has to purchase call termination on reasonable terms and conditions. Again, BT could refer a dispute to Ofcom, but again, would have no certainty as to the outcome of a dispute resolution and again, dispute resolution would be unlikely to result in termination charges at the competitive level.
- 4.157 The evidence therefore shows that the level of CBP held by BT is unlikely to be sufficient to overturn the strong prima facie indicators of SMP flowing from H3G's 100% market share and the absolute barriers to entry.

## Section 5

# Other relevant SMP criteria and developments

## SMP Criteria

- 5.1 As set out in Section 3.1 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. 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.
- 5.3 The Commission has issued Guidelines on market analysis and the assessment of SMP (the 'Commission's Guidelines')<sup>76</sup>, and Oftel<sup>77</sup> and the European Regulators Group (ERG)<sup>78</sup> produced additional guidelines on the criteria to assess effective competition.
- 5.4 The CTM review, which was published on 30 March this year, considers 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 statement.
- 5.5 The June 2004 statement and the third consultation<sup>79</sup> considered the following relevant factors in assessing SMP in respect of the market for wholesale mobile voice call termination on MNOs' networks:
- Market shares;
  - 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

<sup>76</sup> "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](http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/c_165/c_16520020711en00060031.pdf).)

<sup>77</sup> 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](http://www.ofcom.org.uk/static/archive/oftel/publications/about_oftel/2002/smpg0802.htm).)

<sup>78</sup> "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](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).)

<sup>79</sup> See consultation document 'Mobile Call Termination', section 4.14, published 13 September 2006.

- Excessive pricing and profitability (in the June 2004 statement only).
- 5.6 In the June 2004 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 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 third 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 that is subject to consultation. While Ofcom in this document does not rely on this criterion for the re-assessment of H3G's SMP, it is not inconsistent with our proposed conclusion.
- 5.8 As explained at paragraph 3.4 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 April 2007;
  - H3G has a 100% market share on that market, both when measured by volume of calls and revenues; and
  - there are absolute barriers to entry on that market and therefore no potential competition.
- 5.9 As discussed above in Section 4, Ofcom considers there is insufficient countervailing power held by BT to overturn the strong prima facie indicators of SMP flowing from H3G's 100% market share and the absolute barriers to entry in the relevant market, raised by these facts. Ofcom has gone on to consider 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 third consultation reiterates Ofcom's assessment in its June 2004 Statement in this respect. In the June 2004 statement,<sup>80</sup> 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.
- 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

<sup>80</sup> See [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_termination/wmvct/wmvct.pdf](http://www.ofcom.org.uk/consult/condocs/mobile_call_termination/wmvct/wmvct.pdf).

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 termination rates 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 the possibility of competitive entry into each of the MNO's voice termination markets.
- 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 the third consultation in Section 4 to be of less relevance for this consideration, for the same reasons as mentioned in the third consultation.

## Other Developments

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

- 5.16 In its response to the December consultation, H3G considered that Ofcom has not given enough consideration to the effects of the current number portability arrangements on H3G's ability to set charges above the competitive level. In particular H3G claims that the effect of the number portability charging arrangements curbs any pricing freedom it may have.
- 5.17 The current MNP arrangements, as described at Annex E of the June 2004 consultation,<sup>81</sup> 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 H3G's ability to set prices, i.e. that MNOs, including H3G, do not set call termination rates for 'ported in' subscribers. The impact of this arrangement for H3G is a decrease in average termination rate, since H3G's own termination rate is higher than the regulated rates of the other MNOs. However, Ofcom concluded in the June 2004 statement and in the third 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]"<sup>82</sup> 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."<sup>83</sup>
- 5.19 H3G's income from termination is also affected by its domestic roaming agreement with O2. This agreement provides that H3G subscribers can make and receive calls over O2's network where O2's network provides coverage but H3G's does not. The financial terms of this agreement are such that, where a call destined for a H3G subscriber terminates on O2's network, O2 charges H3G its regulated termination

<sup>81</sup> See [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_termination/wmvct/annexe/](http://www.ofcom.org.uk/consult/condocs/mobile_call_termination/wmvct/annexe/).

<sup>82</sup> See [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_termination/wmvct/wmvct.pdf](http://www.ofcom.org.uk/consult/condocs/mobile_call_termination/wmvct/wmvct.pdf), paragraph 3.48.

<sup>83</sup> See consultation document 'Mobile Call Termination', paragraph 4.17, published 13 September.

rate (currently an average of 5.63ppm) whilst H3G charges the originating operator its unregulated (and higher) mobile termination rate.

- 5.20 Ofcom notes the existence and impact of this national roaming agreement but has not relied on this in assessing H3G's SMP.

**Initial conclusions in respect of other relevant SMP criteria and other developments**

- 5.21 Ofcom considers that H3G holds a 100% market share in the relevant market, where there are absolute barriers to entry.
- 5.22 In Section 4, Ofcom has 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.
- 5.23 Taking these factors together, Ofcom 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.

## Section 6

# Remedies and Impact Assessment

- 6.1 As explained in Sections 4.155 and 5.23, Ofcom proposes to designate H3G as having 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 The analysis presented in this Section, when read in conjunction with the rest of this document, represents 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](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 service. In regard to Ofcom's proposal outlined in the present 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, as stated in paragraph 6.4 above, Oftel, in the December consultation considered the other requirements imposed on the 2G MNOs to be either inappropriate, disproportionate or unjustified for H3G for the following reasons:<sup>84</sup>
- 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 has 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;

<sup>84</sup> See [http://www.ofcom.org.uk/consult/condocs/mobile\\_call\\_termination/mct\\_consultation/?a=87101](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 considered to be neither justified, given the difficulties in assessing the costs involved in using a new and innovative 3G service which is likely to require regular updating as H3G aims to minimise the use of its 2G termination service , nor proportionate because:
  - There is insufficient evidence to suggest that H3G will set charges for 2G termination significantly above the industry levels;
  - H3G has 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 a proportionate obligation to impose on H3G at that stage, proportionate to H3G's development in the market at that stage. 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, and allows competing providers to have sufficient time to plan for charge changes, as they may wish to restructure retail prices in response to such changes at the wholesale level.

6.7 In considering the appropriate remedy in the context of this document, Ofcom has taken account of the fact that H3G has grown significantly in size since H3G's initial designation and its termination charges, as set out in paragraph 4.69 are above those of other operators. In this context, Ofcom has considered three options in respect of the appropriate remedy:

- 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 could potentially not 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 whilst, when terminating calls on the 2G network, paying O2 its regulated termination charge which has fallen significantly over time.
- 6.14 However, as set out in paragraph 5.7 above, Ofcom is in the process of consulting on its cost models, and understanding of H3G's cost base. Therefore, Ofcom does not consider proposing a charge control to be proportionate or practical for the period through to April 2007. Therefore, Ofcom does not consider it appropriate to propose such remedies.

### **Option 3 – Set a transparency obligation**

- 6.15 As mentioned above, Ofcom in the June 2004 statement 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, and allows competing providers to have sufficient time to plan for charge changes, as they may wish to restructure retail prices in response to such changes at the wholesale level.
- 6.16 The reporting requirement in relation to call volumes has few disadvantages for H3G up to 31st March 2007 (after which, depending on the outcome of the Calls to Mobile 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 on a regular basis. Ofcom does not consider this to be unduly onerous, as the data should be readily available to H3G.
- 6.17 Therefore, setting a transparency obligation on H3G prior to the work on the Calls to Mobile market review being finalised represents Ofcom's preferred approach. 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 allows transparency and allows competing providers to have sufficient time to plan for charge changes.

6.18 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.

6.19 Therefore, Ofcom is proposing that except insofar as Ofcom may otherwise consent in writing, H3G shall publish 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.
- 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,terminated during the Quarterly Period in question.

6.20 The proposed condition MA1 is set out in the Notification at Annex 3.

## **Legal tests - Ofcom’s duties under the Communications Act 2003**

### **Section 3 – Ofcom’s general duties**

6.21 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’).

- 6.22 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.
- 6.23 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.
- 6.24 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 proposes 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**

- 6.25 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.
- 6.26 For the reasons set out in paragraph 6.24 above, and in particular, that it would allow Ofcom to accurately monitor pricing developments, Ofcom has put in place a transparency obligation. Although Ofcom may find, in the course of its Calls to Mobile Review, that stronger remedies are required 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 review period, a transparency obligation is proportionate.
- 6.27 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.
- 6.28 Ofcom considers that this proposed condition meets the tests set out in section 47 of the Act. The proposed condition is objectively justifiable, non-discriminatory, proportionate, and transparent –
- It is objectively justifiable, in that prior publication of charge changes allows competing PECN providers to 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 proposed SMP in the market whilst reflecting H3G's unique position during this period offering 2G voice call termination only where its own 3G network cannot provide call termination services.
  - It is proportionate, in that only the minimum amount of information required by 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.
- 6.29 Ofcom therefore considers that reinstating the transparency obligation required of H3G in the June 2004 Statement is the most appropriate remedy until the conclusion of the current market review.

- 6.30 Ofcom's Notification and proposed SMP services Conditions is set out in Annex 3 to this explanatory statement. Ofcom proposes that this SMP services condition will remain in place until the conclusion of the current market review.
- 6.31 For the avoidance of doubt, the Notification at Annex A, Schedule1, 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.

## Annex 1

# Negotiation of the Initial Agreement

- A1.1 The negotiations between BT and H3G began in late 2000. Following the conclusion of a confidentiality agreement between BT and H3G on 14<sup>th</sup> 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.
- A1.2 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.
- A1.3 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 1<sup>st</sup> August, reference was made to an 'interim' price, to be agreed between H3G and BT for the testing phase.
- A1.4 On 13<sup>th</sup> August 2001 a Standard Interconnection Agreement was signed between H3G and BT, without the termination charge schedules.
- A1.5 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 range of charges<sup>85</sup>. 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.<sup>86</sup>
- A1.6 On 16<sup>th</sup> 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

<sup>85</sup> Reference to this is made in the first witness statement of John Locker, 11 November 2004, paragraph 34, referring also to the correspondence with H3G on 31 October 2001, 6 November 2001 and 7 November 2001.

<sup>86</sup> First witness statement of James Westby, paragraph 26.

A1.7 On 3 December 2001, BT sent an e-mail to H3G, rejecting its proposal in the following terms:

“BT notes that Hutchinson 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.”

A1.8 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.

A1.9 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.”

A1.10 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.

A1.11 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.

A1.12 On 24<sup>th</sup> 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<sup>87</sup> 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<sup>88</sup>.

A1.13 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).

A1.14 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).<sup>89</sup> 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.<sup>90</sup>

A1.15 Where an OCCN is rejected, the Initial Agreement provides that the Parties “*shall forthwith negotiate in good faith*”<sup>91</sup>. 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*”.<sup>92</sup>

<sup>87</sup> One2One was subsequently taken over by Deutsche Telekom and re-branded as T-Mobile in April 2002.

<sup>88</sup> BT accepted H3G’s proposed termination rates in its letter dated December 24th 2001 by email on January 29th and the Supplemental Agreement was then signed.

<sup>89</sup> Initial Agreement, paragraphs 13.2 and 13.3

<sup>90</sup> Where the Operator does not accept or reject the OCCN within 14 days it is considered rejected for the purposes of the Initial Agreement.

<sup>91</sup> Initial Agreement, Paragraph 13.5

<sup>92</sup> Initial Agreement, Paragraph 13.7

## Annex 2

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

A2.1 Prior to publishing this determination Ofcom has recently requested information from BT and H3G that may be of relevance. In particular, the information request 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 ✂



## Annex 3

# Notification

### NOTIFICATION UNDER SECTIONS 48(2) AND 80 OF THE COMMUNICATIONS ACT 2003

#### Proposals for the making of market power determinations and the setting of SMP services conditions in relation to H3G.

- A3.1 The Office of Communications ('OFCOM') in accordance with sections 48(2) and 80 of the Communications Act 2003 (the 'Act') hereby makes the following proposals for identifying markets, making market power determinations and the setting of SMP services conditions by reference to such determinations ('the Notification');
- A3.2 OFCOM are proposing to identify the following markets for the purpose of making market power determinations:
- wholesale voice call termination provided by H3G (such termination being provided via H3G's mobile network).
- A3.3 OFCOM are proposing to make a market power determination that:
- H3G has significant market power in the relation to the market referred to in paragraph A3.2 above.
- A3.4 OFCOM are proposing to set SMP service conditions on H3G as set out in the Schedule to this Notification.
- A3.5 The effect of, and OFCOM's reasons for making, the proposals to identify the market set out in paragraph 2 above and to make the market power determination set out in paragraph 3 above are contained in the explanatory statement published with this Notification.
- A3.6 The effect of, and OFCOM's reasons for making, the proposals to set the SMP service conditions set out in the Schedule to this Notification are contained in the explanatory statement published with this Notification.
- A3.7 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.
- A3.8 In identifying and analysing the market referred to in paragraph 2 above, and in considering whether to make the proposals set out in this Notification, OFCOM have taken, in accordance with section 79 of the Act, 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.
- A3.9 Ofcom considers that the proposed SMP services conditions referred to in paragraph 4 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.

- A3.10 In making all of the proposals referred to in paragraphs 2, 3 and 4 of this Notification, OFCOM have considered and acted in accordance with the six Community requirements in section 4 of the Act as well as performed its general duties under section 3 of the Act.
- A3.11 Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying explanatory statement by 25 October 2006. Respondents are asked to provide representations in the manner set out in Annex 2 of the accompanying explanatory statement.
- A3.12 Copies of this Notification and the accompanying explanatory statement have been sent to the Secretary of State in accordance with section 50(1) of the Act, and to the European Commission and regulatory authorities of every other member State in accordance with sections 50(3) and 81 of the Act.
- A3.13 Save for the purposes of paragraph 2 of this Notification and except as otherwise defined in this Notification, words or expressions used shall have the same meaning as in the Act.
- A3.14 In this Notification:
- '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.

**Steve Unger**

**Director of Telecoms Technology**

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

**13 September 2006**

## 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:

- 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 1 January 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.

## Annex 4

# Responding to this consultation

## How to respond

Ofcom invites written views and comments on the issues raised in this document, to be made by **5pm on 25 October 2006**.

Ofcom strongly prefers to receive responses as e-mail attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 5), among other things to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.

Please can you send your response to [anne.hoitink@ofcom.org.uk](mailto:anne.hoitink@ofcom.org.uk).

Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Anne Hoitink

Riverside House, 4<sup>th</sup> floor

2A Southwark Bridge Road

London SE1 9HA

Telephone: 020 7783 4190

Fax: 020 7783 4103

Note that we do not need a hard copy in addition to an electronic version. Also note that Ofcom will not routinely acknowledge receipt of responses.

It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 7. It would also help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

## Further information

If you have any want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Anne Hoitink on 020 7783 4190.

## Confidentiality

Ofcom thinks it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential and specify why. Please also place such parts in a separate annex.

If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those which are marked as confidential, in order to meet legal obligations.

Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website, at

[www.ofcom.org.uk/about\\_ofcom/gov\\_accountability/disclaimer](http://www.ofcom.org.uk/about_ofcom/gov_accountability/disclaimer).

## **Next steps**

Following the end of the consultation period, Ofcom intends to publish a statement as soon as possible.

Please note that you can register to get automatic notifications of when Ofcom documents are published, at [http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm).

## **Ofcom's consultation processes**

Ofcom is keen to make responding to consultations easy, and has published some consultation principles (see Annex 5) which it seeks to follow, including on the length of consultations.

If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk). We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.

If you would like to discuss these issues, or Ofcom's consultation processes more generally, you can alternatively contact Vicki Nash, Director, Scotland, who is Ofcom's consultation champion:

Vicki Nash  
Ofcom (Scotland)  
Sutherland House  
149 St. Vincent Street  
Glasgow G2 5NW  
Tel: 0141 229 7401  
Fax: 0141 229 7433  
E-mail: [vicki.nash@ofcom.org.uk](mailto:vicki.nash@ofcom.org.uk)

## Annex 5

# Ofcom's consultation principles

A5.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

### Before the consultation

A5.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

### During the consultation

A5.3 We will be clear about who we are consulting, why, on what questions and for how long.

A5.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A5.5 We will normally allow ten weeks for responses to consultations on issues of general interest. Regarding this Consultation document we have reduced the response time to 6 weeks for the following reasons:

- This consultation document follows from H3G's appeal to its SMP designation on the market for mobile wholesale voice calls on its own network, made in the June 2004 Statement;
- The Competition Appeal Tribunal required Ofcom to revisit one aspect of the 2004 assessment as carried out in the Statement;
- Ofcom expects the same group of stakeholders to be involved as in the June 2004 Statement; and
- Since the current regulatory regime for mobile voice call termination runs out in March 2007, Ofcom would like to provide clarity in respect of H3G's SMP and remedies as soon as possible.

A5.6 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.

A5.7 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.



## **After the consultation**

- A5.8 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

## Annex 6

# Consultation response cover sheet

- A6.1 In the interests of transparency and good regulatory practice, we intend to publish all consultation responses in full on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk).
- A6.2 We have produced a cover sheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A6.3 The quality of consultations can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their cover sheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A6.4 We strongly prefer to receive responses in the form of a Microsoft Word attachment to an email. Our website therefore includes an electronic copy of this cover sheet, which you can download from the 'Consultations' section of our website.
- A6.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only so that we don't have to edit your response.

## Cover sheet for response to an Ofcom consultation

### BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

### CONFIDENTIALITY

Please tick below what of your response you do not want Ofcom to publish, giving your reasons why?

Nothing  Name/contact details/job title

Whole response  Organisation

Part of the response  If there is no separate annex, which parts?

Reason to keep confidential

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

### DECLARATION

I confirm that the response supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations.

If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

## Annex 7

# Consultation questions

*Question 1: Do you agree with Ofcom's assessment of countervailing buyer power held by BT as a purchaser of wholesale mobile voice call termination services from H3G?*

*Question 2: Do you agree with Ofcom's proposal to reinstate the transparency obligation required of H3G in the June 2004 Statement until 31 March 2007?*