EUROPEAN COMMISSION

Brussels, 5.3.2015
C(2015) 1593 final

Office of Communications (Ofcom)
Riverside House

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United Kingdom

For the attention of:
Mr Stephen Unger
(Acting) Chief Executive Officer

Fax: +44 20 7981 3504

Dear Mr Unger,

Subject: Commission Decision concerning Case UK/2015/1706: Voice call termination on individual mobile networks in the United Kingdom

Comments pursuant to Article 7(3) of Directive 2002/21/EC

1. PROCEDURE

On 6 February 2015, the Commission registered a notification from the UK national regulatory authority, the Office of Communications (Ofcom)[1], concerning the market for voice call termination on individual mobile networks[2] in the United Kingdom.

The national consultation[3] ran from 4 June 2014 to 13 August 2014.

On 12 February 2015, a request for information[4] was sent to Ofcom and a response was received on 17 February 2015.

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1 Under Article 7 of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ L 108, 24.4.2002, p. 33, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37, and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12.

2 Corresponding to market 2 in Commission Recommendation 2014/710/EU of 9 October 2014 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 communications networks and services (Recommendation on Relevant Markets), OJ L 295, 11.10.2014, p. 79.

3 In accordance with Article 6 of the Framework Directive.

4 In accordance with Article 5(2) of the Framework Directive.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities (NRAs), the Body of European Regulators for Electronic Communications (BEREC) and the Commission may make comments on a notified draft measure to the NRA concerned.

2. DESCRIPTION OF THE DRAFT MEASURE

2.1. Background

The third review of the market for voice call termination on individual mobile networks in the UK was notified to and assessed by the Commission under case UK/2010/1068[5]. At the time, Ofcom considered that (i) the provision of wholesale mobile voice call termination by each mobile communications provider (MCP) constituted a separate market and (ii) the geographic scope of each product market coincided with the geographic coverage of the network concerned. Ofcom defined 50 separate markets for wholesale mobile voice call termination based on operators' ability to terminate calls to an entity controlling an electronic communications network that hosts and controls access to a mobile number range. Ofcom designated all 50 MCPs as having significant market power (SMP). With regard to the four established and largest MCPs (Vodafone, O2, Orange/T-Mobile, and H3G), Ofcom imposed a range of remedies including symmetric[6] price caps and a glide path towards pure BU LRIC rates to be reached by 1 April 2014. With regard to the remaining (previously unregulated) providers, Ofcom obliged them to meet reasonable requests for access to mobile call termination on 'fair and reasonable' terms.

The Commission in its comments urged Ofcom (i) to reconsider the proposed glide path and align it with the deadline provided for in the Commission's 2009 Termination Rates Recommendation[7] (i.e. 31 December 2012), and (ii) to immediately apply symmetric charges also for H3G. Moreover, the Commission commented on the need to verify the SMP designation of some of the 50 MCPs, and invited Ofcom to shorten its review period from four years to three as required by Article 16(6) of the Framework Directive, as amended by Directive 2009/140/EC.

2.2. Market definition

Ofcom defines the relevant market as termination services provided by each mobile communications provider to another communications provider, for the termination of voice calls to UK mobile numbers (included in the number ranges for 'mobile services' as defined in the UK National Telephone Numbering Plan) allocated to that MCP by Ofcom in the area served by that MCP and for which that MCP is able to set the termination rate. Like in its previous market analysis, Ofcom refers to number allocation rather than 'network', so as to avoid confusion relating to communication providers that do not have their own physical network (but are able to provide termination services), and to underline that the defined markets are technology neutral. Ofcom defined 72 separate markets for wholesale voice call

[5] C(2010)4405.

[6] The proposed rates allowed for higher price caps for H3G in the first year of the price control period.

[7] Commission Recommendation 2009/396/EC of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (Termination Rates Recommendation), OJ L 124, 20.5.2009.

termination on mobile networks, encompassing four large operators (Vodafone, O2, EE and H3G) and 68 smaller operators.

The relevant geographic market coincides with the area for which the MCP can determine the mobile termination rate (MTR) in relation to its allocated UK mobile numbers. This area lies within the UK.

2.3. Finding of significant market power

Ofcom proposes to designate 72 operators as having SMP in their respective markets. The main criteria considered by Ofcom when reaching its conclusion are: market share (each MCP has 100 % share of terminating voice calls on its mobile number range), very significant barriers to entry, pricing behaviour which is consistent with SMP[8] and lack of countervailing buyer power.

2.4. Regulatory remedies

Ofcom proposes to impose on all 72 operators the same access[9] and transparency obligations. With regard to charge control, Ofcom proposes to continue applying a pure BU LRIC methodology to calculate the price caps. However, unlike in its previous market review, Ofcom now proposes to impose the price caps on all 72 SMP operators. In addition, the four largest MCPs will be subject to a no undue discrimination obligation.

With regard to modelling of the efficient mobile termination costs, Ofcom applies the same methodology as previously. However, while not changing the general modelling approach, Ofcom has updated specific parameters of the model, *inter alia* to better reflect the technological advancements (inclusion of 4G technology), and forecasted traffic patterns[10]. The recalculated MTR price cap amounts to 0.521 pence per minute for 2015[11].

With regard to implementation of the recalculated MTR price caps, Ofcom considered three options: immediate implementation (‘one-off adjustment’), ‘one-year adjustment’ (the new rate would be applicable after the first year of the three-year charge control period, i.e. as of 1 April 2016; until that time an interim rate would be applicable, calculated as midway between the current and the recalculated pure BU LRIC model results), or a two-year glide path with progressive reduction of the MTRs and reaching the target rate by 1 April 2017.

In the notified draft measure Ofcom discards the option of a two-year glide path, which would unduly delay the overall benefits of setting MTRs at the new

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[8] Ofcom notes, in particular, that 28 smaller MCPs, on which price caps were not imposed in the previous market review, have a weighted average MTR above the benchmark rate for at least some of their mobile ranges. Furthermore, 11 of these MCPs set MTRs at 10 pence per minute (ppm) or more.

[9] On fair and reasonable terms and conditions, upon reasonable request.

[10] In response to the RFI, Ofcom indicates that, aside from the inclusion of 4G technology and the update of voice and data traffic forecasts (including 4G data and voice traffic), other changes include: (i) Updates in 2G and 3G network technology; (ii) Inclusion of S-RAN technology; (iii) Addition of active infrastructure sharing; (iv) Changes in spectrum holding assumptions.

[11] 0.70 eurocent per minute at ECB exchange rate as of 13 February 2015.

calculated BULRIC levels for competition and consumers. Ofcom, however, proposes to allow a 'one-year adjustment' period in light of the estimated impact of the change on net revenues of MCPs[12]. Ofcom would be concerned if MCPs did not have the opportunity to recover efficiently any incurred costs, including, as appropriate, being able to make adjustments to other prices, such as retail prices. Ofcom estimates that short-term constraints faced by MCPs when adjusting their retail prices and a risk of any price increases being concentrated on certain customer segments, such as pre-pay customers, or on certain charges, such as out-of-bundle charges for post-pay contracts, may result in unexpected price shocks[13].

In response to the RFI, Ofcom states that although the cost standard to be used for MTRs has been known for some time, this does not mean that the industry could have predicted the level of future cost-based charge controls[14]. The reduced MTRs will be implemented according to the following timescale:

	Current MTR from 1.4.2014	From 1.4.2015	From 1.5.2015	From 1.4.2016	From 1.4.2017
Nominal MTR	0.845 ppm (1.14* cent/min)	0.845 ppm (1.14 cent/min)	0.683 ppm (0.92 cent/min)	0.521 ppm (0.70 cent/min)	0.516 ppm (0.69 cent/min)

*ECB exchange rate as of 13 February 2015

12 Amounting to £53 million in 2015/16 (2012/13 prices) compared to existing MTRs, amounting to a reduction of around 0.3% of total MCP retail revenues. Setting MTRs at the new LRIC rate from 1 April 2016 (with a partial adjustment at the start of the first year of the control) would represent a reduction in net termination revenues of £27 million in 2015/16 (2012/13 prices) compared to the existing MTRs.

13 The price increase would affect pre-pay customers the soonest, and post-pay customers only at a later stage since operators would not be able to amend post-pay tariffs until the expiry of the contract, unless they allowed customers to terminate early. If MCPs were to seek to recover the entire revenue reduction of 0.3 % from those contractually committed post-pay customers, MCPs might seek to do so by increasing retail prices for out-of-bundle charges, creating a risk of bill shocks for customers. Ofcom notes that the majority of customers in the UK are on post-pay contracts. Ofcom considers that as many as 85 % of post-pay subscribers could be committed to existing contracts at the start of the first year of the new charge control, which would amount to just under 50 % of total mobile subscriptions. While Ofcom considers that the decrease in MTRs may require an increase in retail tariffs, it has concluded that the waterbed effect is relatively limited, and that the previous decrease in MTRs did not have a negative impact on MCPs' ability to invest.

14 Ofcom cites two reasons. First, the model is based on costs of an efficient MCP, which are likely to be different from the actual costs experienced by MCPs (for example, due to differences in spectrum holdings, market share or coverage). Second, demand, technology and equipment costs vary over time and projecting them in a lifetime network cost model involves regulatory judgment on the basis of available evidence.

3. COMMENTS

The Commission has examined the notification and the additional information provided by Ofcom and has the following comment:[15]

Entry into force of revised pure BU-LRIC mobile termination rates

The Commission notes that Ofcom continues to apply a pure BU-LRIC methodology for calculating MTRs, in line with the Termination Rates Recommendation. The revised model's results entail a substantial reduction of MTRs, compared to their current levels, and would bring the UK MTRs to a level which is amongst the lowest within the EU. However, Ofcom is prepared to delay the entry into force of the revised rates until April 2016.

The Commission reminds Ofcom that, as recommended in the Termination Rates Recommendation, NRAs should ensure that termination rates were implemented at a cost-efficient (pure BU-LRIC) level by 31 December 2012. An initial period of transition was considered necessary to allow NRAs to put the cost models in place and for operators to adapt their business models. The Recommendation, however, does not make provision for any 'adjustment periods' when the models are updated to reflect variations in underlying costs and technological progress, once the efficient rates have been implemented in the market. Delaying the adaptation of rates to reductions in underlying costs does not allow efficiency gains to be passed on to operators purchasing termination services and ultimately consumers.

While the Commission acknowledges that the decrease in the MTRs is substantial, the Commission nevertheless considers that, even if the magnitude of the reduction would have been difficult for operators to foresee, the overall downward trend could have been anticipated by the industry. Given Ofcom's own conclusion that the MTRs should be implemented as soon as possible for the benefit of competition and consumers, the Commission considers that timely introduction of the revised MTRs would have been justified, rather than allowing a period of one year for adjustments.

The Commission takes note of the further explanations by Ofcom, which justify the delay. The Commission also considers the fact that Ofcom is proposing an intermediate rate from 1 May 2015 to 1 April 2016, which would see MTRs moving closer to the calculated level. The Commission therefore does not object to Ofcom's proposal in the specific circumstances, and wishes also to avoid a further implementation delay. However, the Commission asks Ofcom to reconsider the need for a one-year adjustment period and to implement the revised rates as soon as administratively possible.

Pursuant to Article 7(7) of the Framework Directive, Ofcom shall take the utmost account of the comments of other NRAs, BEREC and the Commission and may adopt the resulting draft measure; where it does so, shall communicate it to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take *vis-à-vis* other notified draft measures.

Pursuant to Point 15 of Recommendation 2008/850/EC[16] the Commission will publish this document on its website. The Commission does not consider the information contained

[15] In accordance with Article 7(3) of the Framework Directive.

herein to be confidential. You are invited to inform the Commission[17] within three working days following receipt whether you consider that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication.[18] You should give reasons for any such request.

Yours sincerely,

CERTIFIED COPY
For the Secretary-General,

Jordi AYET PUIGARNAU
Director of the Registry
EUROPEAN COMMISSION

For the Commission,
Robert Madelin
Director-General

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16 Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, OJ L 301, 12.11.2008, p. 23.

17 Your request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32 2 298 87 82.

18 The Commission may inform the public of the result of its assessment before the end of this three-day period.