

Cellnet and Vodafone

Reports on references under section 13 of the Telecommunications
Act 1984 on the charges made by Cellnet and Vodafone for
terminating calls from fixed-line networks



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**Presented to the Director General of Telecommunications
December 1998**

Members of the Monopolies and Mergers Commission as at 4 December 1998

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¹These members, together with Mr S C Finch OBE (selected by the Chairman of the MMC under section 13(9) and (10) of the Telecommunications Act 1984), formed the Group which was responsible for these reports under the chairmanship of Dr D J Morris.

Note by the Office of Telecommunications

Certain material has been excluded from this version of the report following a Direction made by the Secretary of State for Trade and Industry to the Director General of Telecommunications acting in accordance with section 14(6) of the Telecommunications Act 1984 as affected by the requirement of the EC Directive on a common framework for general authorisations and individual licences in the field of telecommunications services in respect of the obligation of professional secrecy and certain business secrets.

The omissions are indicated by a note in the text or, where space does not permit, by the symbol ✂.

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Part I

Summary and Conclusions

1 Summary

Introduction

1.1. On 5 March 1998, the Director General of Telecommunications (DGT) made three references to the MMC relating to charges for calls made from fixed telephone apparatus (fixed lines) to mobile phones. The terms of the three references are set out in Appendix 1.1. Two related to the charges made by Telecom Securicor Cellular Radio Limited (Cellnet) and Vodafone Limited (Vodafone) respectively, to operators of fixed public telecommunications systems (fixed network operators or FNOs) for the delivery of calls to mobile phones on their respective mobile telephone networks, including charges for unanswered and diverted calls. The third reference related to the charges made by British Telecommunications plc (BT) to users of its fixed lines for calls made to mobile phones (fixed-to-mobile calls) on the Cellnet and Vodafone mobile phone networks.

1.2. The three references were investigated in parallel by the same Group of members of the MMC. We have submitted a separate report to the DGT on the reference relating to the charges made by BT. This volume deals only with Cellnet's and Vodafone's charges. Certain of the appendices form part of only the Cellnet report, and certain form part of only the Vodafone report.

1.3. Mobile network operators (MNOs) such as Cellnet and Vodafone charge FNOs a termination charge for the connection of fixed-to-mobile calls. We are asked to report whether the termination charges made by Cellnet and Vodafone and their charges for unanswered calls, and unanswered calls which are diverted, operate against the public interest and if so whether the effects adverse to the public interest can be remedied or prevented by modifications to their licences under the Telecommunications Act 1984 (the 1984 Act). If we so conclude, the DGT is required to modify the licences to remedy the adverse effects.

Termination charges

1.4. The DGT considered that Cellnet's and Vodafone's termination charges were excessive, and should be regulated so as to be cost reflective. He believed that Cellnet and Vodafone were able to set the charges without significant market pressure, because someone wanting to make a fixed-to-mobile call had no choice but to call the network to which the called party had subscribed. Cellnet and Vodafone maintained that there was competitive pressure on termination charges. They recognized that this was only recently so, but said that a number of factors were increasingly contributing to such pressures.

1.5. We examined competition in call termination looking at, among other things, recent trends in charges, consumer price sensitivity, alternatives to fixed-to-mobile calls and the competitive pressure that may be exerted by mobile phone users who also have a direct interest in charges for incoming calls. We conclude that there is currently insufficient competitive constraint on termination charges.

1.6. We note, however, that mobile telecommunications is still a relatively immature service in the UK. The industry and the technology are evolving rapidly and new competitive pressures may emerge. The client base is growing in size and experience and it is possible that charges for incoming calls will assume greater competitive significance in future. In these circumstances we do not believe we have a sufficient basis to expect that competitive constraints on termination charges will remain inadequate beyond the next three or four years.

1.7. In the light of arguments put to us by the MNOs, the DGT and others we conclude, first, that in principle termination charges should be cost-oriented. Alternatives to a cost-based approach such as demand-led pricing, which was proposed to us, in our view provided neither a better nor a more practicable starting point for determining the public interest. However, many of the costs involved are fixed and common to outgoing and incoming calls and it was necessary therefore to determine an appropriate allocation of these costs across different types of call. We also allowed for a reasonable return on capital, which we concluded was 16.5 per cent.

1.8. Second, we conclude that only efficiently incurred costs should be taken into account in determining the public interest benchmark. We base our assessment of efficient costs on Vodafone's costs as overall these were substantially lower than those of Cellnet. We do, however, take account of the extent to which Cellnet's costs were unavoidably higher because of its currently lower volume of traffic and the significant effect which this has on unit costs.

1.9. Next, we considered whether there might be any public interest benefits in Cellnet's and Vodafone's termination charges being higher than was necessary to recover their efficiently incurred costs and an adequate return on capital. We conclude that this is not necessary either to ensure quality of service or efficient levels of investment. However, in view of the possibility that termination charges could become an element of competition in the future, we considered that there were advantages in charges being above Vodafone's costs. These are relatively low because of Vodafone's higher market share and economies of scale. We saw a risk that charges strictly reflecting Vodafone's costs could inhibit other MNOs from making termination charges a competitive issue, to the longer term detriment of consumers.

1.10. We resolve this problem by using as our public interest benchmark the efficiently incurred costs of an operator assuming it had 25 per cent of the current and anticipated market. With, currently, four MNOs and no new entrants being licensed to operate before 2002, this benchmark is achievable by any or indeed all of them. This benchmark figure we estimated as 12.15 pence per minute (ppm) for 1998/99 and 11.38 ppm for 1999/2000, dropping to 9.98 ppm in out-turn prices by 2001/02.

1.11. The charges introduced by Cellnet and Vodafone in August 1998 are 22 per cent above the current benchmark and 30 per cent above the benchmark for 1999/2000. We conclude that these charges operate against the public interest, and that they may be expected to operate against the public interest over the next three years.

1.12. After considering a variety of types of modifications to Cellnet's and Vodafone's licences we conclude that the only effective means of remedying or preventing the adverse effects would be to impose a price control on termination charges.

Unanswered and diverted calls

1.13. Both Cellnet and Vodafone charge for calls terminating on a recorded message, and charge for unanswered calls which are diverted to another phone from the time the diversion is announced.

1.14. We consider that these practices lead to callers incurring costs that they cannot predict or control and are therefore against the public interest. We considered that the adverse effects could be remedied or prevented by modifications to Cellnet's and Vodafone's licences preventing them from *(a)* charging for calls answered by recorded announcements and *(b)* charging for unanswered calls which are diverted, until they are answered. However, we allow for the costs incurred in terminating such calls to be charged to successful fixed-to-mobile calls, in parallel with the treatment of these costs in the fixed-line sector. This adds 0.32 ppm to the public interest benchmark, taking it to 11.7 ppm for 1999/2000.

Conclusion

1.15. Under our proposals, Cellnet and Vodafone would be required to reduce their weighted average termination charge for 1999/2000 to 11.7 ppm, reducing it by RPI-9 in 2000/01 and by RPI-9 again in 2001/02. Combined with our proposals in the report on BT's charges, this would reduce the average charge for a fixed-to-mobile call by around 25 per cent below the current average rate, and approximately 30 per cent below the rate applying when the DGT made the reference.