Richard Feasey
Public Policy Director

vodafone

Mr Douglas Webb
Telecommunications Commissioner
New Zealand Commerce Commission
Level 10, 44-52 The Terrace
PO Box 2351
Wellington New Zealand

28 July 2004

Dear Douglas

REGULATORY POLICY TOWARDS MOBILE TERMINATION: COMMENTS ON THE PAPER SUBMITTED BY PROFESSOR MARTIN CAVE ON BEHALF OF TELSTRA/CLEAR

I wish to comment briefly upon one aspect of the paper submitted by Professor Cave.

It is worth noting that there are some matters on which I would agree with Professor Cave. For example, I would agree with his suggestion that 'absent regulation, we might expect mobile operators to reach mutually acceptable agreements which would not involve monopoly pricing' (page 3). As with a number of other points in his paper, this is a rather simplified presentation of what is in fact a complex issue. But I would endorse his conclusion.

The issue I want to address in this note is Professor's Cave's claim that Vodafone has expressed the view in the UK that the supply of wholesale termination on each mobile network is a separate market (page 2). This comes as a surprise to me, since this has been and remains a major point of disagreement between Vodafone and European regulators. It is a point that we consider to as yet unresolved.

Professor Cave is correct to suggest that Vodafone has not argued that there is a 'multi operator termination market', by which I assume he means that there is supply side substitution of termination between the operators on a call by call or customer by customer basis. I am not sure any operator in Europe has claimed otherwise.

However, Vodafone has consistently held the view that operators do compete for termination revenues through competition for mobile subscribers – and that a proper market analysis cannot artificially separate such activities. More formally, Vodafone contends that mobile markets are 'two sided', with one side being subject to very strong demand side constraints. Further, entry into only one side of the market is not possible since termination services can only be supplied in conjunction with complementary outbound services and vice versa. We have consistently argued that the 'narrow' single

Vodafone Group Services Limited
Vodafone Group Services Limited
Bell House, The Connection, Newbury, Berkshire RG14 2FN, England
Telephone: +44 (0)1635 33251, Facsimile: +44 (0)1635 686

Registered Office: Vodafone House, The Connection, Newbury, Berkshire RG14 2FN, England. Registered In England No. 3802001

network market definition favoured by some European regulators is erroneous in such circumstances.

The Competition Commission fairly recorded Vodafone's position in their report of 2002:

> *"...Vodafone considered that the most useful definition which we could adopt of the relevant market was a market for the provision of all services provided via mobile networks in the UK. This reflected the fact that, if an MNO were to raise termination charges to levels which generated revenues in excess of any relevant measure of cost, it would be forced by competition from other MNOs offering services to subscribers to feed any excess revenues back to subscribers via lower subscription and outbound charges. Profits earned from the provision of mobile services were determined by the totality of prices charged, and not merely by the prices charged for one specific component of the services.*
>
> *Vodafone believed that its own proposed market definition was more useful than the DGT's* [Director-General of Telecommunications] *because it better identified the full range of factors affecting call termination charges. In particular, Vodafone's proposed market definition revealed that, even if call termination charges were set at an inefficiently high level, that did not mean that MNOs would make excessive profits, because any excess would be fed back into competition to serve subscribers. Vodafone therefore did not accept either the DGT's conclusion that there was a separate market for call termination on each mobile network or his rejection of the possibility that there was a market for call termination which was part of a cluster of linked national markets for mobile services.*
>
> *Vodafone believed that, under the general principles of competition law, a market was defined by identifying what was the narrowest range of products which a firm would need to monopolize in order to be able profitably to raise prices above competitive levels. In the UK the operators competed effectively to win and serve mobile subscribers. It would never be profitable for a single operator to raise its call termination charges above a given level even if this generated additional revenues. This was because its price increase could be matched by other operators, and competition among the operators to provide low-priced services would then force each operator to return any surplus call termination charge revenue to subscribers by lower charges. In practice, one operator would use its additional revenue from call termination charges directly to lower its other charges and other operators would have to follow. Vodafone believed that in order to be able to raise prices to a level generating excess profits without losing customers, a single MNO would have to have a monopoly of all mobile phone services, so that, to the extent that it could increase call termination charges above competitive levels, it could expect to retain*

the resulting additional revenues, rather than having to plough them back into lower charges to mobile subscribers." [1]

More recently, OFCOM also quoted Vodafone in their Statement on Wholesale Call Termination of 1 June 2004 as arguing:

> *'There is a clear economic linkage between origination and termination services which are provided over a common infrastructure. This means that it is wholly wrong for Oftel to conclude that there is no supply-side substitutability between the termination services of the various MNOs...If Orange or O2 wishes to provide termination services to a Vodafone customer they can do so quite readily by winning the customer and offering Orange or O2 services. The fact that termination is one of a number of services in the packages cannot change the reality that other suppliers exist and that they are competing hard to win such customers..'* [2]

I trust these citations are sufficient to dispel any suggestion that Vodafone has accepted the single network market definition in respect of call termination.

I would like to make one further point. Professor Cave implies that approaches that differ from the 'single network' market definition have few supporters in Europe. Whilst this may be true of the regulators themselves, there is in fact considerable debate amongst other academic commentators on precisely this issue. An important paper written by Professor Jordi Gual for the Competition Directorate of the European Commission in September 2002 considered the approach adopted by Oftel (and subsequently by other regulators) to this issue:

> *'The analytical approach of Oftel, however, does not follow the usual antitrust methodology. The UK agency assesses first the degree of competition in call termination, and then moves onto determine the relevant markets. Yet the procedure should be precisely the reverse. Start with an analysis which determines the relevant markets, and then proceed, for each of those markets, to an examination of the competition conditions and the potential for abuse of market power...If the analysis of the mobile market is done in this fashion the results may be strikingly different...* [3]*'*

Professor Mark Armstrong and others have suggested that mobile markets are properly understood as being an example of 'two sided' markets[4]. They are not 'two markets'. And

---

[1] Competition Commission (UK) (2002) *Vodafone, O2, Orange and T-Mobile: Reports on references under section 13 of the Telecommunications Act 1984 on the charges made by Vodafone, O2, Orange and T-Mobile for terminating calls from fixed and mobile networks*, paras 14.57-14.59 (p. 399). (www.competition-commission.org.uk/inquiries/completed/2003/vodafone/index.htm)

[2] OFCOM (2004) *Statement on Wholesale Mobile Voice Call Termination*, para 2.13. (www.ofcom.org.uk/consultations/past/wmvct)

[3] Professor Jordi Gual, *Market definition in the Telecoms Industry*, September 2002, p. 40. (europa.eu.int/comm/competition/antitrust/others/telecom/market_definition.pdf)

[4] See, eg, Professor Mark Armstrong (August 2002 and revised February 2004) *Competition in Two-Sided Markets* (www.econ.ucl.ac.uk/downloads/armstrong/venice.pdf)

in these circumstances it is very often the case – rather than being contrary to normal practice as Professor Cave suggests - that retail and wholesale customers coexist in two-sided markets. Examples commonly cited would include newspaper purchasers and advertisers or games developers and games users.

A full exposition of Vodafone's views on market definition appear in our main submission. It will be apparent that these differ from those attributed to us by Professor Cave.

Yours sincerely

Richard Feasey
Public Policy Director