3 UK Response to the European Commission's consultation on the Revision of the Recommendation on Relevant Markets

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This paper contains the response of Hutchison 3G UK Ltd ("**3 UK**") to the European Commission's consultation on the revision of the Recommendation on Relevant Markets.

Summary

3 UK welcomes the opportunity to comment on the European Commission's review of the Recommendation on Relevant Markets (the "Consultation").

3 UK notes that the Commission seeks responses on several matters. However, this response will focus on one issue: the regulation of SMS termination rates. In doing so, this response addresses questions 11 and 12 in the consultation. 3 UK believes that, in some Member States, regulation of SMS termination rates is necessary and, for this reason, SMS termination should be included in the revised Recommendation as a market presumptively in need of *ex ante* regulation.

3 UK points to the following factors which suggest that SMS termination regulation should be included in the revised Recommendation:

- In some Member States, SMS termination rates are significantly out of step with mobile voice call termination rates and cannot be said to be cost-reflective. The principles of SMS and voice termination and their market definition are comparable as are the potential harms.
- Some operators are applying discriminatory termination charges to cross-border SMS. These charges threaten innovation and the common market principles of cross-border trade.
- The Commission itself has recognised in the roaming context that regulation of wholesale SMS charges is required to prevent excessive prices. Similar principles apply to domestic SMS termination charges.[1] Regulation of SMS termination rates is required to ensure they are consistent with the EU rules on non-discrimination and do not distort competition.

Introduction

The market conditions that require regulation of voice termination on mobile networks are the same for SMS termination. Each operator has a monopoly for terminating SMSs sent to its customers, there are insurmountable barriers to entry such that the markets will remain monopolies and not tend towards competition and competition law is unlikely to address the market failure. Therefore, just as voice termination is a relevant market, we believe SMS termination should also be a relevant market.

[1] Regulation 531/2012

Divergent approaches and prices are emerging across the EU. In some Member States, mobile operators have been agreeing bilateral reductions in SMS termination charges. In others, domestic SMS termination is regulated (e.g. in France), whereas, in other Member States, SMS termination rates remain high. This is leading to a divergence in SMS termination rates across the EU.

A further distortion arises because some EU mobile operators levy higher SMS termination charges on SMSs originated by operators outside their home country than they do for SMSs sent to them by domestic operators. In some cases these cross-border SMS termination charges are as high as 6 €cents. Not only are such charges artificially high, but they are also in glaring contrast to the regulated wholesale rate for SMS under the Roaming Regulation (which does not apply in such instances[2]).

Detailed Points

The 2007 Recommendation[3] included the market for voice call termination on individual mobile networks as a market presumptively in need of regulation (specifically "Market 7" in the Annex to the 2007 Recommendation). By way of aside, 3 UK notes that the Commission is also consulting on whether it remains appropriate to use the "three criteria test" to assess whether markets should be included in the Recommendation. 3 UK believes it does remain appropriate and assumes for the purposes of this response that it will be retained.

The three criteria test provides that a market is susceptible to *ex ante* regulation if the following criteria are met:

- the presence of high and non-transitory barriers to entry;
- a market structure which does not tend towards effective competition within the relevant time horizon; and
- the insufficiency of competition law alone to adequately address the market failure(s) concerned.

3 UK notes that the Explanatory Note to the 2007 Recommendation (the "Explanatory Note") provided a relatively detailed explanation as to why the three criteria test was met in respect of mobile voice call termination. Importantly, the Explanatory Note was also clear throughout that the same reasoning applied to SMS termination and explicitly noted that "*to the extent the exchange and termination of SMS are considered to result in similar market power problems, it is open to NRAs to consider defining and notifying an additional separate market for SMS*"[4]. In some Member States there are similar market power problems and, for that reason, 3 UK considers that the Commission now needs to go further and include SMS termination as a separate market in the revised Recommendation. This will make it clear to

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[2] So far as wholesale SMS conveyance is concerned, the Roaming Regulation only applies to the charge made by the roamed on network for relaying a message back to the home network. As such it relates to the "mobile origination" ("MO") charge made where a customer is roaming, but not to the termination charge where a message is sent cross-border.

[3] Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation (2007/879/EC), OJ, L344/65, 28.12.2007) (the "2007 Recommendation")

[4] Page 44 of the Explanatory Note.

regulators in those Member States where there are such market failures, that the regulatory tools exist to remedy the excessive prices. It is unsatisfactory that SMS termination rates are being reduced in some Member States through commercial negotiations or regulatory pressure while in others they remain high.

3 UK also notes that, in the present circumstances, it remains clear that the three criteria test is met when applied to SMS termination:

- It remains a fact that a mobile operator has a collection of customers for which it has a monopoly for terminating SMS traffic which cannot be overcome by competitors. Accordingly, high and non-transitory barriers to entry continue to exist for SMS termination services.

- The market for SMS termination shows few signs that it will tend towards effective competition in the foreseeable future. While there is clearly some demand-side substitutability at the retail level for SMS services (for example instant messaging), these services still do not constrain operators when they set wholesale SMS termination charges. 3 UK notes the Commission's observation in the Explanatory Note that empirical evidence did not suggest such substitutability constrained termination charges. 3 UK considers the position remains the same in 2013.

- As the experience since the 2007 Recommendation demonstrates, competition law is not sufficient to address high SMS termination rates.

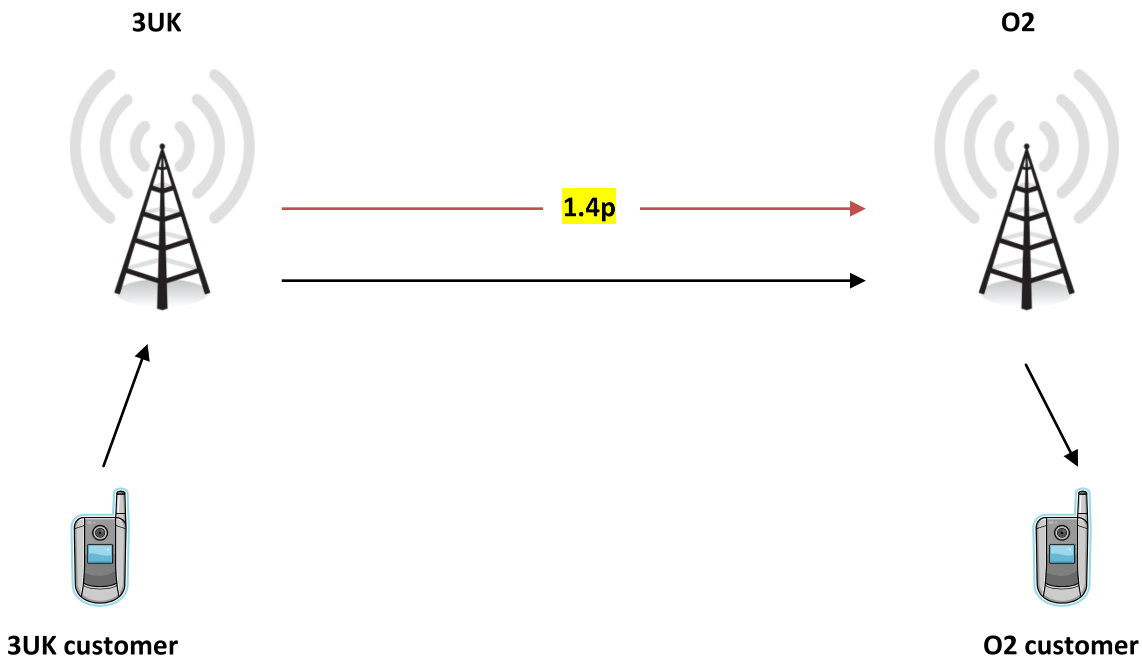
For the above reasons, 3 UK considers that, on the basis of the Commission's own reasoning set out in the Explanatory Note, the market for SMS termination is susceptible to *ex ante* regulation and should therefore be included as such in the revised Recommendation.

In some Member States, SMS termination rates are out of line with voice termination rates

It is notable that, in some Member States, SMS termination rates remain high and have not decreased even as voice termination rates have fallen as regulators have implemented the Commission's 2007 Recommendation. This has meant that, whereas a few years ago SMS termination rates were a fraction of voice termination rates this is no longer the case: for example, in the UK the cost of terminating a single SMS is currently higher than the cost of terminating 60 seconds of voice traffic, and will be significantly higher when voice termination rates fall to the Commission's recommended LRIC level in April 2013. It follows then that monopoly providers of SMS termination levy charges that are wholly removed from any measure of cost orientation.

Figure 1 below shows the charges in the illustrative example of an SMS sent by a Three customer on the Three network to an O2 customer on the O2 network (i.e. neither customer is roaming). As noted above, this charge is higher than the LRIC cost of terminating a 60 second voice call.

Figure 1 – Domestic to Domestic SMS (non-roaming)[5]



Relatively high SMS termination rates have similar consequences to mobile termination rates on economic incentives, efficiency, innovation and the ability of new entrant's to compete on a level playing field. Furthermore, there is a significant and growing market for wholesale SMS services (e.g. the use of SMS by banks, national health services etc. to communicate with consumers) but the scope and potential of this market is inevitably constrained by the cost of reaching consumers. Reducing SMS termination rates would significantly increase the potential for the extension and innovation of such services.

Beyond addressing the risk of spam (which would be a significant issue absent a material termination rate), there appear to be few reasons to distinguish the reasoning of the Commission's Recommendation from the market for SMS termination.

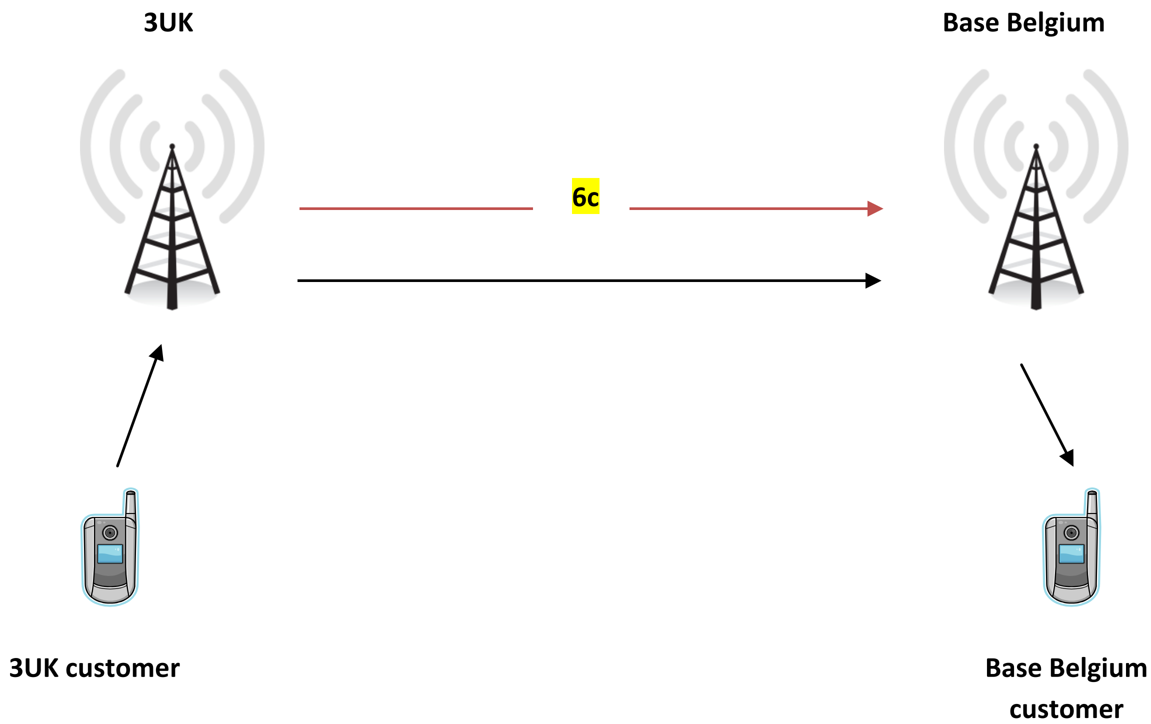
Discriminatory termination charges for cross-border SMS threaten common market principles

The contrast between domestic and cross-border SMS termination rates is stark and revealing. There is an emerging a discrepancy between the termination charges some operators levy for domestic SMS and for cross-border SMS.

Figure 2 illustrates the charges imposed on cross-border SMS when a consumer is not roaming (i.e. when a UK consumer in the UK sends a message to a Belgian consumer in Belgium). In this example scenario, 3UK may incur as high as 6 euro cents per SMS.

[5] Text highlighted in yellow is confidential and business sensitive.

Figure 2 – Domestic to other EU SMS (non-roaming)

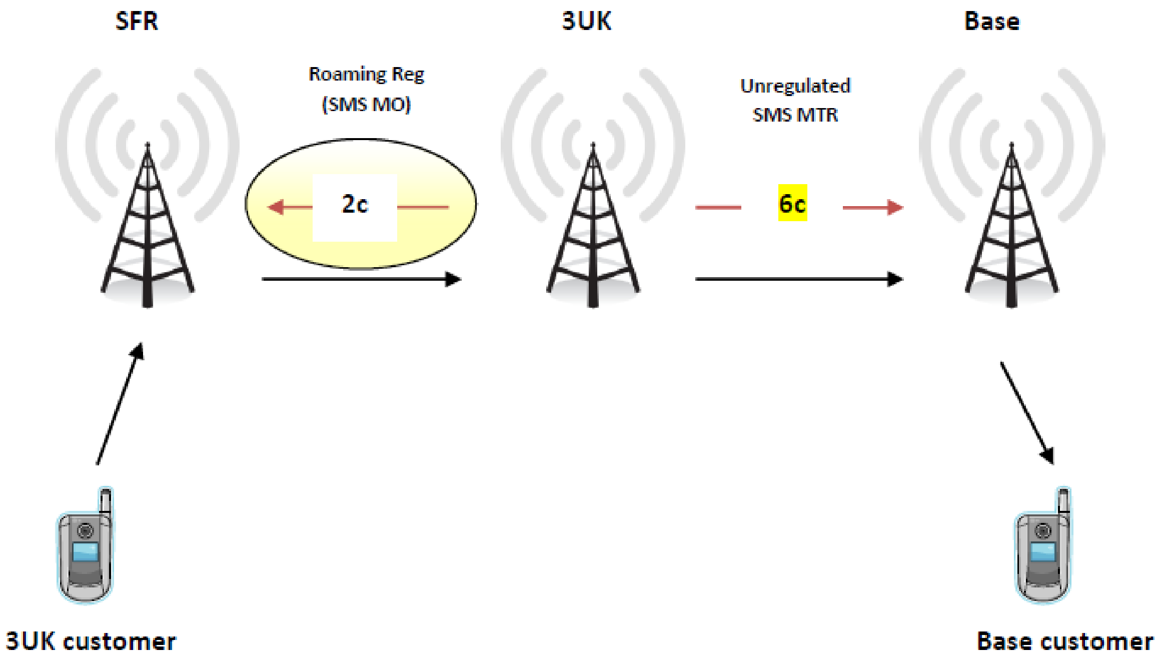


The fact that SMS termination rates for cross-border SMS are too high is further illustrated when one considers the effect of the Roaming Regulation.

Under the Roaming Regulation, wholesale SMS charges are required to be no more than 3 €cents and will fall to a maximum of 2 €cents from 1 July 2013 for the conveyance of the SMS at a wholesale level back to the home network. The Roaming Regulation was introduced as a direct response to the high level of wholesale and retail international roaming charges imposed by various operators in different Member States and the inadequacy of the Regulatory Framework to address these issues (due to their cross-border nature).

Figure 3 illustrates the role that the Roaming Regulation plays in regulating the wholesale SMS charge when a 3UK customer roaming on SFR, France sends an SMS to Base, Belgium customer on their home network. As can be seen, in this scenario, 3UK incurs 2 charges: firstly it is charged by SFR for the SMS “origination” by its customer (this charge is subject to the Roaming Regulation), secondly it is charged an SMS termination rate by Base - this charge is unregulated and is three times higher than the origination charge under the Roaming Regulation.

Figure 3 – EU roaming to other EU SMS (France)



Whereas the roaming regulation constrains the SMS origination charges on a cross border basis when the originating consumer is roaming outside their home member state, it does not constrain the cost of termination, when the receiving customer is on their own network.

The Roaming Regulation therefore does nothing to improve cross border communications within the common market when consumers are in their native Member State. Accordingly, networks continue to charge rates consistent with a monopolist and barriers to cross-border communications and associated service innovation remain high[6].

It follows that there are multiple scenarios where the cost of SMS termination can be multiples of the domestic rates. Not only is this potentially discriminatory, but it significantly constrains the use of such services at both a retail and a wholesale level. Removing these potentially discriminatory practices and achieving further integration of the common market is likely to require regulatory intervention.

Conclusion

Although in some Member States mobile operators have lowered wholesale SMS charges over time (e.g. UK and Italy), this is not the case in all Member States. Even with these reductions, domestic and international termination rates remain at high, non cost-oriented, levels. Beyond this, from an EU perspective there are a range of common scenarios in which charges are discriminatory and wholly inconsistent with the underlying aims of the Roaming Regulation and the Common Market.

[6] To further compound this problem, there are instances where national SMS termination rates are regulated (such as in France), but cross border SMS termination rates are not. In such instances the termination charges for wholesale cross-border SMS are significantly higher than the national regulated rate.

For all the above reasons, **3 UK** considers that the Commission should include the market for SMS termination services on an individual mobile network in the revised Recommendation as a market presumptively in need of regulation. This will facilitate regulation of SMS termination in those Member States where the market or other forms of regulatory intervention have not succeeded in bringing down SMS termination rates. It may also potentially ensure greater harmonisation and innovation in cross-border charges and services.