April 2002

COMPLAINT SUBMITTED UNDER THE COMPETITION ACT 1998 (THE ACT) BY THE FEDERATION OF WHOLESALE DISTRIBUTORS ALLEGING AN INFRINGEMENT OF THE PROHIBITION IMPOSED BY SECTION 2(1) OF THE ACT BY VODAFONE LTD

Relating to Vodafone’s participation in certain distribution agreements fixing resale prices for pre-pay mobile phone vouchers.

INTRODUCTION

1. This case concerns an allegation that Vodafone Ltd (“Vodafone”) was infringing the prohibition on anti-competitive agreements set out in section 2(1) of the Competition Act 1998 (the “Chapter I prohibition”) by virtue of its participation in distribution agreements (the “Agreements”) with a number of distributors (“the Distributors”) to fix the retail prices of pre-pay mobile phone vouchers.

The Parties

2. Vodafone operates public telecommunications systems and provides certain mobile telecommunications services by means of them. Vodafone provides a direct pre-pay mobile telecommunications service to customers, known as “Pay As You Talk” (“PAYT Services”).

3. A number of undertakings act as distributors of Vodafone’s pre-pay mobile phone vouchers (the “Distributors”). The vouchers are used by customers (end users) to purchase mobile airtime for PAYT Services.

The Complaint

4. The Director’s investigation was initiated by a complaint from the Federation of Wholesale Distributors (“FWD”). The FWD represents cash and carry and delivery wholesalers in the United Kingdom. Network companies such as Vodafone provide pre-pay mobile phone vouchers. A number of cash and carry wholesalers acquire these phone vouchers from the Distributors for wholesaling to independent retailers.

5. Under the terms of the Agreements, the Distributors must sell pre-pay mobile phone vouchers at their face value (i.e. in fixed denominations of £5, £10, £20 and £50). Further, certain clauses in the Agreements have the effect of preventing sub-distributors and retailers from reselling pre-pay mobile phone vouchers at prices other than that stated on the face of each pre-pay mobile phone voucher. The FWD alleged that because the final price to the consumer is fixed on the face value of the voucher there is, effectively, resale price maintenance by Vodafone.

The Director’s Investigation

6. The Director investigated a number of Vodafone’s standard distribution agreements, which include resale price maintenance clauses. Vodafone has two forms of standard distributor agreement: the standard distributor agreement as used
before the end of 2000 (the “pre-2000 Agreements”) and the standard distributor agreement as used after 2000 (the “post-2000 Agreements”). There is no suggestion that the Distributors party to each agreement acted together in an anti-competitive manner. Rather the investigation has addressed each individual (vertical) agreement.

7. Following an initial examination of the complaint, the Director considered that there were reasonable grounds for suspecting that Vodafone was in breach of section 2(1) of the Act (the “Chapter I prohibition”) by entering into the Agreements with Distributors.

The Agreements

8. The pre-2000 Agreements state at clause 3.3:

“…if the voucher has printed on it a given monetary face value, the Distributor may not sell the voucher at a different price. The Distributor is responsible for ensuring that its sub-contractors and retailers comply with this requirement”.

9. Under the pre-2000 Agreements the Distributor is appointed as Vodafone’s non-exclusive representative in the UK for PAYT Services i.e. the provision of airtime on Vodafone’s network. Clause 2.3 provides that the Distributor “shall not be entitled to enter into any agreements for the actual provision of those services or hold itself out as being entitled to bind Vodafone in any way in relation to the PAYT Services”.

10. However, clause 4 of the pre-2000 Agreements modifies the provisions in clause 2.3. Clause 4 states that the Distributor shall operate as principal (i.e. not as agent) for the distribution of the vouchers represented by the “Top Up Cards”, but not for “the service they represent”. The “Top Up Cards” which represent the vouchers are pre-printed cards containing a reference number to enable the customer to purchase additional PAYT Services for his or her airtime account held by Vodafone. In addition, clause 6.4 provides that “risk of loss or damage to any consignment of Top Up Cards shall pass to the Distributor from the time of receipt of delivery of the Top Up Cards by the Distributor”.

11. The post-2000 Agreements state at clause 5.3:

“If any voucher has printed on it, or refers to, a stated monetary face value, the Distributor shall not sell the voucher (or advertise it for sale) to Customers or potential Customers other than at face value price or tariff, unless otherwise expressly agreed by Vodafone. The Distributor may therefore not discount either face value of the voucher or otherwise the value of a top up”.

12. The post-2000 Agreements also state at clause 5.4:

“…the Distributor shall ensure that each of the Sub-Distributors complies with the obligations on the Distributor referred to in Clause…5.3…”

13. “Sub-Distributor” is defined as “any third party who sells any Products or means of topping up the Pre-pay Services, on behalf of or with the approval of the Distributor and such third parties shall include retailers”.

2
14. Under the post-2000 Agreements the Distributor is appointed as Vodafone’s non-exclusive representative in the UK for PAYT Services. Clause 2.2 provides that the Distributor “shall not be entitled to enter into any agreements for the actual provision of those services or hold itself out as being entitled to bind Vodafone in any way in relation to the Pre-Pay Services”.

15. However, Schedule 1 to the post-2000 Agreements details the Distributor’s relationship with Vodafone in the supply of “paper vouchers” and modifies the provisions in clause 2.2. For the purposes of supplying “paper vouchers” (as distinct from the service of supplying airtime) paragraph 1.2 of Schedule 1 makes it clear that the Distributor operates as principal (i.e. not as agent) for the distribution of such vouchers, but not for “the service they represent”. In addition, paragraph 4.4 of Schedule 1 provides that risk of loss or damage to the “paper vouchers” will pass to the Distributor on delivery by Vodafone. Again, as for the pre-2000 Agreements, these provisions are inconsistent with the status of an agent for the purposes of the supply of the vouchers.

Vodafone’s representations

16. Vodafone argued that the Agreements are, in fact, agency agreements under which Vodafone, as a service provider, retains control over its tariffs, promotional/branding activities, and the integrity of the top-up system. The end customer’s contract for mobile telecommunications services is with Vodafone. Accordingly, in Vodafone’s view they do not infringe the Chapter I prohibition.

17. Vodafone also argued that the Chapter I prohibition does not apply because the Agreements are drafted in such a way as to ensure compliance with its licence requirement in respect of price publication. Condition 58.3 of Vodafone’s Telecommunications Act licence requires that Vodafone shall “provide…services…at the charges, terms and conditions so published, and shall not depart therefrom…”.

ECONOMIC AND LEGAL ASSESSMENT

Relevant markets

18. Resale price maintenance involves a vertical agreement and so two markets are involved: the relevant upstream market and the relevant downstream market. The agreements are between Vodafone, a mobile network operator, and distributors of pre-pay vouchers. Vodafone supplies vouchers to the Distributors using agreements requiring resale price maintenance. But the purpose of the resale price maintenance restriction is to affect retail prices - the agreement specifies that Distributors are to ensure that retailers to whom the Distributors sell cards do not offer discounts when they sell vouchers to end users. Accordingly, the analysis below is to define the relevant retail market.

19. The Director considers that the retail market is distinct from the wholesale market. On the demand side, wholesale services constitute inputs into retail services, so the two are not substitutes, due to a limited demand and supply side substitution in response to a price rise by a hypothetical monopolist at the wholesale
level. However, the Director recognises that the competitive conditions in the retail sector are to a certain extent driven by those in the wholesale sector. This is because much of the retail sector is characterised by tied service providers (i.e. mobile network operators which are vertically integrated into the downstream retail market).

**Product market**

20. The Director is of the view that mobile airtime is in a separate market from fixed telephony. This is because of limited demand and supply side substitution. From a demand-side perspective, the value that end users place on the attractive characteristics of mobile telephony means that fixed calls are not a sufficiently close substitute to provide a competitive constraint on mobile call prices. From a supply-side perspective, fixed network operators are not likely to have any significant advantages in switching into retailing mobile services compared to any other service providers, which would render their ease of supply side substitutability as low.

21. Mobile customers can purchase mobile airtime in two ways: pre-pay eg using vouchers, or contract, eg monthly billing in arrears. From the customers’ perspective airtime purchased via contract has the same characteristics as that purchased using vouchers. The Director considers that demand-side substitution between pre-pay and contract is sufficiently easy to render unprofitable a price increase by a hypothetical monopolist of airtime purchased through vouchers. In addition, since all four networks were able to switch resources into developing pre-pay platforms within a relatively short period, it is apparent that there is supply side substitutability between the two products. The Director concludes, therefore, that mobile airtime purchased by contract is in the same market as mobile airtime purchased through pre-pay vouchers. This market includes the suppliers of mobile airtime on all of the mobile networks.

22. The Director considers that SMS (Short Message Service) and voice services may not be in the same market due to evidence of consumer behaviour regarding SMS on the demand side. This is because the extent to which a fully interactive conversation can occur is severely restricted, and the length of SMS calls is such that voice calls and SMS calls are unlikely to be considered substitutes for a large proportion of mobile subscribers. Although it is possible that supply-side substitutability may exist between voice and SMS, for the purpose of analysing this case he has defined separate markets. The Director's conclusions would be unaffected however, if a single market covering both voice and SMS were defined.

23. Other mobile data services exist, such as internet access using Wireless Application Protocol (WAP), but they are relatively immature which implies that market definition is not straightforward. In the interests of simplicity the Director has abstracted from such services in his market definition, because of their relative immaturity and relatively low volumes in the relative period of time. The Director considers that this simplification has no effect on his conclusions in this case.

---

1 For a more detailed analysis of this and other market definition issues, see Effective competition review: mobile. A Statement issued by the Director General of Telecommunications, 26 September 2001
Geographic market

24. A hypothetical monopoly supplier of retail mobile airtime in the UK will not be constrained in charging above the competitive level by UK consumers purchasing mobile airtime in other countries. Mobile airtime purchases in other countries for calls in other countries would not be a useful substitute for calls in the UK. Calls in the UK can be purchased through suppliers of retail mobile airtime overseas, but international roaming charges would be incurred. These are substantially higher than the prices of calls in the absence of roaming, to such an extent that they do not provide a competitive constraint on charges in the UK.

25. A smaller geographical market than the UK is not appropriate because mobile networks do not generally differentiate their prices on a regional or local basis, so that the competitive conditions faced by consumers throughout the UK are relatively homogenous.

26. On the supply side, suppliers from abroad would face high barriers to entry into the supply of mobile airtime in the UK, such as obtaining spectrum, sunk costs in building a new network and establishing a brand in the UK.

27. Accordingly, the Director considers the relevant geographical market to be that for the UK.

Conclusion

28. The Director considers that the relevant retail markets in which Vodafone pre-pay vouchers are supplied are for mobile airtime for voice and SMS (Short Message Service) in the United Kingdom.

Applicability of the Chapter I prohibition

29. Section 2(1) of the Act prohibits agreements between undertakings, decisions by associations of undertakings or concerted practices, which may affect trade within the United Kingdom, and which have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom, unless they are exempt or excluded. Section 2(2) of the Act states that section 2(1) applies, in particular, to agreements, decisions or practices which, “directly or indirectly fix purchase or selling prices”.

30. Section 3 of the Act provides for certain types of agreement to be excluded from the prohibition and empowers the Secretary of State to provide by Order for additional exclusions.

31. By article 3 of SI 2000/310 the Secretary of State provided that the Chapter I prohibition shall not apply to an agreement to the extent that it is a vertical agreement. A “vertical” agreement is defined in the Order as,

“an agreement between undertakings, each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain, and relating

2 The Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000
to the conditions under which the parties may purchase, sell or resell certain goods or services”.

32. However, article 4 of SI 2000/310 provides that this exclusion,

“shall not apply where the vertical agreement, directly or indirectly, in isolation or in combination with other factors under the control of the parties has the object or effect of restricting the buyer’s ability to determine its sale price, without prejudice to the possibility of the supplier imposing a maximum sale price or recommending a sale price, provided that these do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties”.

33. Since the Agreements have the effect of fixing the resale price of pre-pay mobile phone vouchers, the exclusion in the Order does not apply in this case.

34. The Agreements do not fall under the exemptions contained in sections 4 (individual exemptions), 6 (block exemptions), 10 (parallel exemptions) and 11 (exemption for certain other agreements) of the Act. The Agreements do not appear to contribute to the improvement of the production or distribution of goods, or promote technical or economic progress.

35. The prohibition in Section 2(1) of the Act only applies to agreements between independent undertakings. The prohibition does not apply to genuine agency agreements. An agency agreement will be genuine if the agent bears none of the commercial risk of carrying out the transactions on behalf of the principal (ie the agent is merely the tool of his principal).

36. In VZW Vereniging van Vlaamse Reisbureaus v VZW Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten the European Court of Justice (“ECJ”) stated that the test for agency is whether a person can be treated as “an auxiliary organ forming an integral part of a…undertaking.” In addition, the question of whether a principal and its agent are independent for competition law purposes is dealt with at paragraphs 12-20 of the Commission Notice: Guidelines on Vertical Restraints.

37. It is the Director’s view that the Agreements are not agency agreements insofar as they deal with vouchers. As noted in paragraphs 9 to 15 above, the Agreements expressly provide that although Vodafone acts as principal in respect of PAYT Services, the Distributor shall operate as principal (and not as agent) for the distribution of pre-pay mobile phone vouchers. In addition, the risk of loss or damage to any consignment of vouchers passes to the Distributors on delivery. Vodafone does not appear to control the Distributors. These terms are inconsistent with the status of an agent for the purpose of the supply of pre-paid vouchers. The Agreements are, therefore, agreements between independent undertakings. The Distributors are not acting as agents in respect of the distribution of vouchers.

---

3 Case 311/85 [1987]ECR 3807
4 Ibid. para 20
38. Since the Agreements fix the resale prices of pre-pay phone vouchers in the UK, the Director takes the view that the Agreements are capable of affecting trade in the UK.

**Object or Effect of the Prevention, Restriction or Distortion of Competition in the UK**

39. Agreements must have “as their object or effect” the effects on competition prohibited under Section 2 of the Act. This follows the test applied in Article 81 of the EC Treaty, as interpreted by jurisprudence of the ECJ and the decisions of the European Commission. European jurisprudence shows that there is no need to fulfil both criteria. In *Consten and Grundig v Commission*, the ECJ held that “there is no need to take account of the concrete effects of an agreement once it appears that it has as its object the prevention, restriction or distortion of competition”.

40. In addition to the European jurisprudence, the Director General of Fair Trading has produced guidance on the application of the Act which states, “Where prices are fixed absolutely, or minimum prices are specified, there will be no price competition between the retailers affected. The Director General expects to find all such restrictions in breach of the Chapter I prohibition and unlikely to benefit from exemption.”

41. The clauses in the Agreements explicitly and directly fix the resale prices of pre-pay mobile phone vouchers. Therefore, the Director would usually be entitled to conclude that the Agreements have the object of preventing, restricting or distorting competition. However, as explained in paragraphs 42 to 49 below, Condition 58 of Vodafone’s licence requires Vodafone to maintain the resale price of vouchers to end-users and to the extent that Condition 58 applies, the prohibition in Section 2 of the Act is disapplied.

**Licence Condition 58.3**

42. Condition 58.3 of Vodafone’s Telecommunications Act licence requires that Vodafone shall “provide...services...at the charges, terms and conditions so published, and shall not depart therefrom...”.

43. Schedule 3, paragraph 5(1) of the Act provides that “the Chapter I prohibition does not apply to an agreement to the extent to which it is made in order to comply with a legal requirement.” “Legal requirement” is defined, for the purposes of that paragraph, to mean, “a requirement imposed by or under any enactment in force in the United Kingdom”. The requirements of Condition 58 of Vodafone’s licence are imposed under Section 7 of the Telecommunications Act 1984.

44. The Director considers that Condition 58.3 requires that Vodafone’s standard distributor agreements to be drafted so as to ensure that vouchers are sold to the customer (end user) at Vodafone’s published prices - ie at their face value. Otherwise, a customer could receive mobile airtime for more, or less, than the published price.

---

6 (56 & 58/64) [1966] ECR 299, at 341
7 “Assessment of Individual Agreements and Conduct” (OFT 414) at para 6.8
45. Condition 58.3 requires that Vodafone shall “provide [telecommunications] services” in accordance with published charges, so the Condition relates to the provision of service to an end-user or customer who consumes the airtime which the voucher represents.

46. Clause 5.3 of the post-2000 Agreements provides that, “If any voucher has printed on it, or refers to, a stated monetary face value, the Distributor shall not sell the voucher (or advertise it for sale) to Customers or potential customers, other than at the face value price or tariff, unless otherwise expressly agreed by Vodafone.” Clause 5.3 places a restriction on the price that a Customer must pay for the voucher.

47. The post-2000 Agreements are, therefore, drafted so as to ensure compliance with Condition 58.3 – they require that the end-user pays the price printed on the face of the voucher. The Director concludes that, since this Condition requires Vodafone to maintain the resale prices of vouchers to end users, to the extent that this Condition applies, the prohibition in Section 2(1) of the Act is disapplied under paragraph 5(1) of Schedule 3 of the Act.

48. On 5 April 2002 the Director removed the determination that Vodafone has market influence under Condition 56 of its licence, which has disapplied Condition 58 to Vodafone. Therefore, from that date the exclusion to the Section 2(1) prohibition under paragraph 5(1) of Schedule 3 of the Act no longer applies. However, Vodafone has provided undertakings not to enforce clauses relating to resale pricing of vouchers and to amend the Agreements in this respect (see paragraph 51 below).

49. Clause 3.3 of the pre-2000 Agreements provides that, “Vodafone shall be entitled to amend, replace, suspend or discontinue any of the PAYT services or the tariff at which the PAYT services are sold, at any time and from time to time. Therefore, if the voucher has printed on it a given monetary face value, the Distributor may not sell the voucher at a different price. The Distributor is responsible for ensuring that its sub-contractors and retailers comply with this requirement.”

50. The Director notes that this clause has been applied to the price at which vouchers are sold to end consumers, and not to the price at which vouchers may be transferred between distributors, sub distributors and retailers. In practice Distributors sell the vouchers to sub-distributors and retailers at a price below the face value, to enable the sub-distributor or retailer to make a margin on sales.

51. Further, Vodafone has already expressly confirmed to the Distributors that it will not enforce the clauses in existing contracts relating to resale pricing of vouchers. Vodafone has also given an undertaking to the Director that by 30 April 2002 it will have written to the Distributors giving three months’ notice under their existing contracts of its intention to terminate the Agreements, with a view to replacing them with new distributor agreements that do not require vouchers to be sold at face value.
THE DECISION

52. On the basis of the facts, and for the reasons, set out above, the Director has decided that Clause 5.3 of the post-2000 Agreements has been drafted to ensure compliance with Condition 58.3 of Vodafone’s licence, and that this Condition requires Vodafone to maintain the resale prices of vouchers to end users. The Director concludes that, to the extent that this Condition applies, the prohibition in Section 2(1) of the Act is disapplied to the post-2000 Agreements under paragraph 5(1) of Schedule 3 of the Act.

53. In the light of both the requirements of Condition 58 and the undertakings given by Vodafone (as detailed in paragraph 51 above), the Director has decided to close this case.

Peter Waller
Director of Operations

5 April 2002

a person duly authorised by the Director General under paragraph 8 of Schedule 1 to the Telecommunications Act 1984.