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MVNOs – Key Legal Issues

Introduction

Mobile Virtual Network Operators were virtually unknown before the early 90s, but now there are dozens globally, with more in the pipeline. The theory is simple: there is limited spectrum available for mobile network operators ("MNOs"), so there can only be a small number in each territory. Anyone else wanting to enter the market has to re-sell capacity from MNOs. An MVNO takes this to its logical conclusion: the company becomes more than a reseller by adding its own brand and services to the raw airtime and, to its customers, *is* the network operator.

This paper examines some of the drivers for the creation of MVNOs and the legal issues which have to be addressed in creating one.

Drivers for the creation of MVNOs

For the MNO	For the MVNO
Another channel to market, in addition to "pure" resellers, but often at better than wholesale rates	Brand extension
Maximise network utilisation: o sell more minutes o if the MVNO is targeting a different market sector (eg business users rather than leisure users), there will be more even use of network capacity	New channel/portal for existing products and new value added services
Penetrate new markets by using MVNO's brand strength – domestic and interconnect	Cheaper than becoming an MNO: o unlikely to need a licence o little or no infrastructure costs o may be able to rely on MNO's interconnect and roaming agreements o may be able to benefit from MNO's ability to buy in bulk, eg SIM cards o can outsource most operations (see below)

The MNOs of course have an additional driver in this market: many of them have extended themselves financially to win 3G licences and face the additional financial burden of having to roll out a 3G network - when the cost of borrowing for them has risen as their credit ratings fell. MVNOs may represent a way of exploiting their new spectrum allocation and network without having to market to every sector.

In some jurisdictions, such as Hong Kong, there may also be regulatory pressures on MNOs to resell spectrum in this way.

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Structuring the MVNO

There are two basic models for the relationship between the MNO and the MVNO: arm's length commercial contract or joint venture. Each of these has its own challenges.

Contract model

This is where the MVNO enters into a service contract with the MNO but without the MNO having any ownership stake in the MVNO. Typically, the MVNO is in fact established as a new company by an existing business - such as a retailer or manufacturer - to keep it distinct from its core business. In this note this organisation is termed the Established Business ("EB"). The service contract would cover the provision of network capacity and related services - see the discussion of the Mobile Services Agreement below.

Advantages of this model include:

- simplicity: there is no need to create a JV company which would involve expense (both to set it up and in terms of future corporate reporting obligations) and would have all the attendant problems of any JV:

    - control: who makes decisions on a day to day basis? What matters require unanimity between the shareholders and how would deadlock be avoided?
    - investment: agreeing which party was to put in the initial and subsequent capital and whether this should be by diluting the other party or by way of debt
    - sharing benefit: should dividends be payable? interest on debt? preferential shares?
    - exit: all JVs come to an end - would each party have pre-emption rights over the other's shares? What if there was a disagreement as to, for example, an IPO? Similar considerations of course apply to the bringing in of new shareholders.

- clear allocation of risk and responsibilities, in the Mobile Services Agreement (see below)

Joint venture model

In this option, again there is a new company but this time it is jointly owned by the MNO and the EB. Virgin Mobile in the UK is the most obvious example of this model - Virgin extended its brand into mobile services by entering into a JV with one2one (now T-mobile).

Advantages of this model include:

- external funding: if the venture is being funded by an external source of finance, such as a bank, it may be easier to obtain funding if both the MNO and the EB are participants and there are ring-fenced assets and agreements on which to give security

- culture: depending on the degree of network connection, some MNOs feel as a matter of principle that it would be inappropriate for a totally independent company to have access to network resources and information

- revenue sharing: if the MVNO is run as a JV company, both the MNO and EB can not only see how the business is functioning but directly share the benefits by way of distribution to the shareholders or on IPO or other exit.

MVNEs

The EB may choose not to create an MNVO at all, but to buy in equivalent services from a Mobile Virtual Network Enabler - an organisation which has established itself as an MVNO but for the purpose of sitting behind a brand owner and providing a "white label" ready-made mobile service. This is particularly attractive for an EB that needs to launch a service quickly or where the aim is to target a narrow market sector which would not justify the creation of its own MVNO.

The contract between the EB and the MVNE will have many of the characteristics of the Mobile Services Agreement and other services/outsourcing agreements, as discussed below.

Key issues in the Mobile Services Agreement

Irrespective of the model, there will always be a services agreement between the MNO and the MVNO under which, at its most basic, the MNO provides mobile voice and data services to the GSM standard, packet-switched services via GPRS and EDGE and 3G UMTS services. An overview of these services would be:

Service/obligation	Legal issues
Allocating a range of numbers or other identifiers to the MVNO for onward issuance to customers (this may include the "provisioning" ie programming of SIM cards)	○ ensuring regulatory compliance as to issuing of numbers ○ who "owns" the numbers - important on exit (see below) ○ compliance with number portability obligations and market practice[1]
Allowing holders of such SIM cards to register on the MNO's network for the purposes of making and receiving calls and sending SMS text - ie to provide mobile telecoms services	○ defining service levels for mobile services is notoriously difficult, given the inherent unreliability of signal paths etc. However, response times and availability of the fixed elements of the network structure can be specified and the MNO will have reporting obligations to (at least) the regulator about service standards across its territory ○ allocation of risk and reward may be contentious, given the likely business impact of a service failure on the MVNO - see Risk and Reward, below
Providing billing information (in the form of Call Duration Records or "CDRs") to enable the MVNO to invoice its customers	○ service levels are again important, as the accuracy and timing of information are critical to the business of the MVNO ○ where real time information is needed (eg to validate pre-pay customers), the service levels are even more critical

[1] For example, MNOs may be entitled to charge for porting customers and their numbers between networks, but waive this is a matter of practice - the MVNO should not be at a disadvantage as compared with an MNO when it comes to the cost of taking on new customers

Service/obligation	Legal issues
	○ there may be complex data privacy issues as regards information which can be linked to any specific individual, which need to be addressed in the MSA and may affect the ability to transfer such data over national boundaries
Providing support and other services as agreed between the parties	○ these services may include the provision of handsets, or call centre services or other forms of technical or logistical support. Each needs to be the subject of specific contractual obligations and service levels - see Risk and Reward, below

Additional services and issues typically include:

Service/obligation/issue	Legal issues
Intellectual property in:	
○ branding	○ as noted above, a principal driver for the EB may be the leverage of its brand in a new service area. The EB (and hence the MVNO) will want to be very clear about the use of its brand, particularly if the MVNO is a JV company ○ the MNO may insist on a “powered by…” credit on the MVNO’s packaging and literature. The MNO will want to ensure its brand is properly used in this context; the EB and MVNO will want to make sure that the market perception of the MVNO as being a “real” network operator is not compromised
○ software, content and information	○ one area for care is ownership of the “layers” of software on the SIM card: these typically comprise the network software which enables the SIM card to register on the network; software proprietary to the MNO and applications proprietary to the MVNO or its content providers. Ownership of these layers and rights to update or change them need to be clearly set out ○ network interface information may be needed by the MVNO, for example to allow an external CRM provider to receive billing information from the MNO’s network systems. The MNO may regard these interfaces as being not only highly confidential but critical to the functioning of its network and be reluctant either to release the information or allow direct interfacing with its systems
Market segmentation and exclusivity	○ if the parties agree that they will not compete in particular market sectors (eg the MNO will target the consumer market and the MVNO the business

Service/obligation/issue	Legal issues
	market) then this will need to be examined from a competition/anti-trust viewpoint ○ similar concerns will apply if the MNO wishes to be the exclusive provider of the services to the MVNO or the MVNO wishes to prohibit the MNO from providing similar services to other MVNOs in a particular market
Fraud and security	○ mobile phone theft and fraud are major concerns and the MNO will have policies and procedures on reporting and deactivating stolen or lost SIM cards. These will probably be operated collaboratively with other MNOs, and the MVNO will need to reflect these arrangements in the contract and to ensure that the MNO is obliged to report and deal with any fraudulent use it detects
Ownership of customers	○ the MNO may regard itself as having a proprietary interest in the relationship between the MVNO and its customers. This needs to be considered carefully, especially where there is an arm's length contract rather than a JV, as the rationale behind an MVNO is that the customer has a contract with the MVNO, not the MNO. Any confusion of roles may lead to lack of clarity as to risk allocation and liability to customers and may make exit more difficult (see below) ○ the MNO may in any case seek to impose an obligation on the MVNO to include certain terms in its customer contracts. It is important that the parties do not agree to any form of price maintenance, but provisions relating to fraud prevention etc would be legitimate to insist on.
Risk and Reward	○ the tariff (and any discounts) available to the MVNO is likely to be conditional on expected minimum volumes and the MVNO must ensure that its business planning is sufficiently robust to meet these volumes ○ clearly the MVNO is completely dependent on the MNO for its ability to provide its services: any major or prolonged service failures will therefore affect not only the revenue but also the viability of the MVNO as a business. Given this, the MVNO will have a legitimate desire to hold the MNO liable for a degree of business loss (eg loss of profits). This is a contentious issue in any services contract, but the trend in other business-critical technology contracts has been for service providers to accept at least some liability for business losses.
Roaming	○ the MVNO will want to offer its customers the

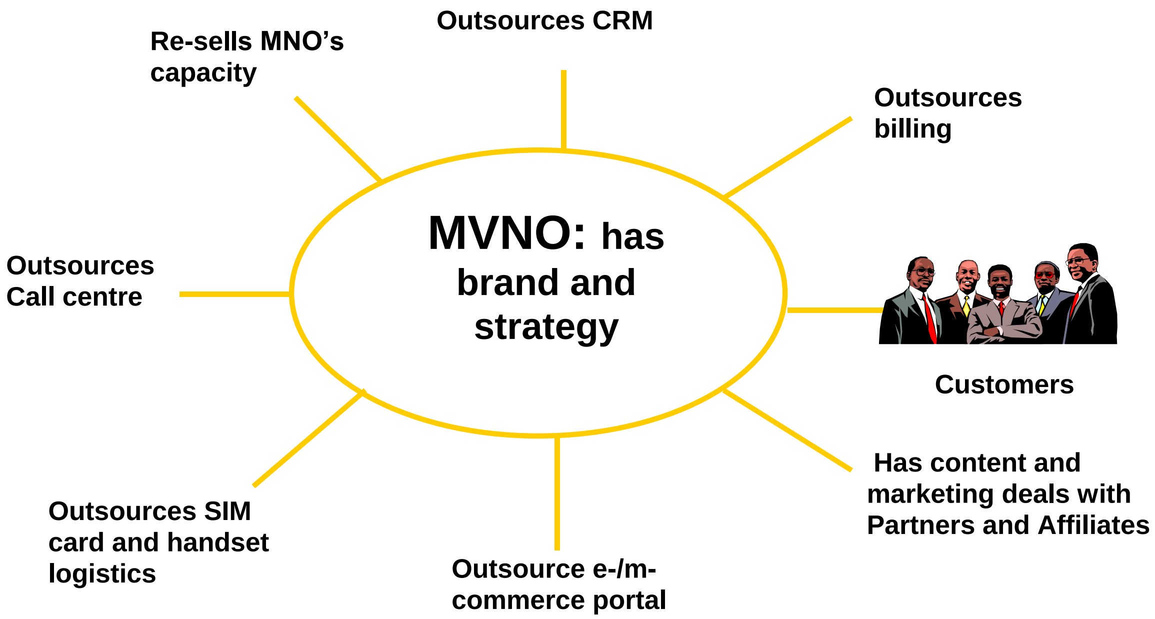
Service/obligation/issue	Legal issues
	ability to roam between mobile operators, domestically, where possible, and overseas. It is unlikely to be possible for the MVNO to enter into roaming agreements itself with other operators so it will take advantage of the arrangements already entered into by the MNO with its roaming partners. o the terms of the existing roaming agreements will not be negotiable by the MVNO and may not be disclosed by the MNO. The MVNO will instead need to concentrate on major issues, such as whether agreements exist - and will be maintained - for key countries and on the range of services which are provided via roaming partners. o the MVNO will need to know how CDRs are exchanged between the MNO and its roaming partners, and the time taken for billing information to be transferred. Linked to this is the basis on which tariffs are set - and changed. The MVNO does not want to undercharge its customers due to delays in the exchange of information, changes in tariffs or exchange rate fluctuations and should certainly be in no worse a position than the MNO itself.
Migration to 3G services	o obviously the MVNO is unlikely to have entered into the deal without having some idea of the MNO's timescales and other plans for introducing new services. However, it may not be possible for the parties to agree at the time of the contract exact details of launch dates, the services to be launched, the roll-out plans and the financial arrangements. o nevertheless, the contract should set out both the principles and the procedures for agreeing these issues, and the process for resolving disputes. The principles could include, for example, that the MNO will launch its services no later than an agreed period after the first 3G launch in its territory.
Exit	o as with any services agreement, the rights and obligations of the parties on exit must be clearly set out. The aim of course is for any change of MNO to be largely invisible to the MVNO's customers and for any necessary changes - eg of SIM cards - to be as straightforward as possible. The details of the process will vary with the scenario and with, for example, local practice and regulations on number allocation and portability. o it is therefore essential that the contract contain not only the principles to apply on termination, but

Service/obligation/issue	Legal issues
	also that the parties agree (and keep under regular review) an exit plan for how migration to a new MNO would be accomplished. Where the MNO terminates the agreement for fault - or because the MVNO is to cease trading - it may wish to specify that the affected customers are to migrate to direct contracts with it.

Outsourcing other services

An MVNO, as noted above, is often constituted as an entirely new company. As such, it has the option not to build a large infrastructure of support and other functions but instead to run as a "virtual" company, contracting for such services.

A model of this would be:



This raises two principal challenges:

- coming to agreement with each of the relevant service providers on all the issues common to any such services agreement, such as: defining the services and services levels; managing change in the services; controlling the price of the services; allocating risk and reward and establishing remedies for service failures; dealing with regulatory, tax, data privacy and confidentiality issues; dealing with any copyright or other IP issues and, finally, agreeing rights relating to re-tendering, termination and exit.[2]

[2] These issues are examined in detail in our separate note on Outsourcing - Key Issues

- coordinating the negotiation of all the relevant agreements so that they are in place for the intended launch date and thereafter managing the multiple relationships.

As noted above, these issues can to some extent be circumvented by entering into a single contract with an MVNE, although this of course also means that all the business risk is also concentrated on that one relationship.

Conclusions

MVNOs are an established reality in the UK and across much of the rest of Europe, with the US market poised for rapid growth. The Asia-Pacific market has seen the playing out of mistakes as well as successes. Economic conditions for MNOs, the need for existing businesses to extend into mobile commerce and changes in technology all combine to point to the MVNO model as an increasingly important one.

In establishing an MVNO - it is critical to understand:

- the legal environment and the terms which need to be incorporated in the agreements underpinning the venture; and

- how to coordinate that understanding and approach across the multiple agreements and arrangements which breathe life into the MVNO.

Please see our website for further papers, podcasts and information about our legal and training services.

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