



Wholesale mobile voice call termination – preliminary consultation on future regulation

MCI's Response to Ofcom's Consultation

Submitted to Ofcom: 30th August 2005

About MCI:

MCI is a leading global communications provider, delivering advanced communications connectivity to businesses, governments and consumers. With one of the world's most expansive, wholly-owned data networks, MCI offers an extensive portfolio of innovative Voice, Data and IP communications services that are the foundation for commerce and communications in today's market.

Through 38 Points of Presence and 12 data centres in the UK, MCI provides services to more than 30,000 business customers across the UK. Major sectors served by MCI are finance, retail, government, technology and production, and it has become one of the main competitors in the “business to business” sector. For more information on MCI in the UK visit <http://www.mci.com/uk>

MCI is also a member of UKCTA and supports the response submitted by UKCTA to this consultation.

Overview:

MCI welcomes the opportunity to respond to this consultation as it looks at a problem which is seen by industry to have been enduring for an overly long period.

MCI continues to believe that the charge controls applicable to mobile voice call termination do not adequately address the negative effects which are evident as a result of excessive mobile termination rates.

MCI remains convinced that it is the existence of these excessive mobile termination rates, remaining as they do disproportionately high in relation to costs, that generate demand for GSM gateways. MCI is disappointed that Ofcom is seemingly consulting on these two matters in isolation when in reality the issues are inextricably linked.

Mobile termination rates are still too high and the negative effects of this cannot be allowed to continue to prevail into the future to the continuing detriment of consumers and industry alike. MCI especially feels that it is time for Ofcom to adequately address the prevailing problem of excessive mobile termination rates, in advance of widespread implementation of 3rd Generation mobile applications - and hopes that the regulator will move to achieve that required rate reduction as a consequence of this consultation.

MCI therefore applauds Ofcom's desire to remove the underlying causes of SMP in this market. MCI supports the achievement of that shared desire, but cautions against treating the pursuit of a competitive solution as an end in itself, particularly as the structure of the mobile market might result in an oligopolistic rather than truly competitive outcome. Therefore, in the absence of a truly competitive market, MCI believes that Ofcom should concentrate on ensuring *effective* controls are imposed on termination rates set by each MNO.

MCI welcomes Ofcom's statement that MNOs currently face an incentive to set their charges for voice call termination at the profit maximising (monopoly) level – but is concerned by Ofcom's suggestion that “a condition requiring that charges should be cost oriented or fair and reasonable may serve as a useful safeguard”, as this appears to be delegating interpretation of ‘fair and reasonable’ to the MNOs, whom Ofcom has already acknowledged as being insufficiently motivated to address this problem without the assistance of effective controls.

Therefore, although MCI considers that a workable option might become available at some future point which doesn't rely on regulation by means of charge controls, the structural options considered within the consultation all have major drawbacks. MCI therefore agrees that Ofcom should not attempt to implement any of these options at the present time. In the interim, and for at least the medium term, MCI supports regulation, to include effective charge controls on mobile termination rates. Above all, it will be unacceptable for regulation to be withdrawn in the hope that a market-driven solution will appear. Only the emergence of **actual** competition in the provision of mobile termination will justify the removal of price regulation.

However, there is the further complication in that, to date, such charge control on mobile termination rates has applied to 2nd Generation mobile networks only. MCI is keen to see this extended to include controls of charges for the termination of calls on both 2nd and 3rd Generation networks. Key to the effectiveness of such controls would be the accurate allocation of costs between these two network types, to ensure that calls to subscribers on a 2nd Generation network were not artificially subsidising the development of and migration to 3rd Generation networks.

Therefore, whereas in the longer term it is reasonable to expect costs to be lower on 3rd Generation networks than on 2nd Generation networks, in the short term this is not the case due to the low volume of calls currently terminated on the former. Further, in the short term, the requirement to operate two networks in parallel will be inefficient. However, this inefficiency should be a cost wholly associated with 3rd Generation, and should not be inappropriately apportioned to and paid by callers whose calls to mobile subscribers are terminated on 2nd Generation networks.

MCI also believes that regulated termination rates must be based on the most efficient technology. This means that the price control which includes both 2nd and 3rd Generation networks should not result in a higher price than currently exists (regardless of the technology used to actually terminate the call) and may well result in a regulated price substantially lower. Any approach which doesn't do this would risk creating a perverse incentive to favour a less efficient technology at the expense of a more efficient one.

MCI supports Ofcom's efforts towards re-evaluating 2nd Generation mobile termination costs, particularly as these costs are now below previously predicted levels. However, MCI remains convinced that the current cost model still *significantly* over-estimates the true costs of terminating a call on a mobile network. As the costs of an efficient operator have not been used in the setting of controls, mobile termination rates remain excessively high and continue to result in distortions of the market due to inefficient transfer of economic resources from the fixed to the mobile sector.

In the consultation, Ofcom poses a number of specific questions, for which MCI offers the following responses:

Question 1. Could RPP principles be made to work to the advantage of consumers in the UK? If so, how?

Charging their own customers for receiving calls is open to the MNOs but they (correctly) choose not to do so because, unlike in North America, they are allowed to recover the full cost of inbound calls through termination charges. The system in North America is, in fact, not a pure RPP environment because MNOs recover a termination charge from the originating operator, but this is limited by regulation to the rate charged by fixed operators.

An RPP environment cannot be imposed by regulation. Rather, the regulator can create the conditions in which it is likely to evolve by restricting termination charges to below the true cost of termination. MCI does not recommend this option, even though it may be in MCI's commercial interests: there is a danger that a receiving party pays approach would simply introduce its own distortions.. Instead, MCI recommends that Ofcom should pay closer attention to ensuring that the LRIC estimates are truly cost reflective.

Further, RPP is likely to be unpopular with mobile subscribers, who might be reluctant to answer incoming calls or even keep their mobile handsets switched on due to the costs to them of accepting call charges for calls received when they are unable to evaluate the importance and value to them of that call – whereas they can more readily assess that value prior to initiating calls on a calling party pays basis.

Question 2. Is it realistic to believe that a competitive market for wholesale termination of voice calls could be made to operate successfully? How might such arrangements work?

MCI's view is that introducing technological changes to allow the MNOs to compete directly in call termination is theoretically possible. However, we believe the costs may considerably outweigh any benefits, if, indeed there are any benefits at all. The costs of development and implementation would be extremely high, significant cost and inconvenience would be caused to end-users (multiple subscriptions, SIM cards and lower battery life, for example) and the outcome of competition in the market would be scarcely any different to the current situation in which termination charges are price-controlled. In fact, given the structure of the market, it is unlikely that such competition would give rise to cost-reflective pricing.

Question 3. Is VoIP likely to have a significant impact on the market for mobile voice call termination during the period to 2010? What are the possible obstacles to this outcome and how might industry or Ofcom overcome these?

Of all the options considered, the only one that MCI believes may permanently remove the underlying cause of SMP is a market in which VOIP runs on portable devices over unlicensed spectrum with similar coverage to existing mobile networks.

The features of the market that would lead to the underlying causes of SMP to be eroded are sufficient availability of spectrum to allow multiple operators to offer broadband connectivity to devices running open standards. Under such circumstances, competition would lead to the widespread availability of unmetered internet connections that customers would use to make and receive calls. This is technically possible using 3G, but the current price per bit is too high to be economic for voice calls (currently the price of VoIP calls over 3G networks is higher than the price of regular mobile calls).

Unmetered tariff plans are available but these are currently too expensive for widespread adoption.

The high prices of 3G data is likely to be related to the unwillingness on the part of the MNOs to cannibalise their premium applications, which are charged by bit and the oligopolistic structure of the market that restricts the choice of tariff plans, preventing for example the evolution of cheap “no frills” IP access. In addition, MCI sees potential problems with latency at the network edge (which will continue to be controlled by the mobile operator) and also with presence and location information.

MCI does not anticipate that sufficient rollout of networks with unlicensed spectrum will have occurred to bring competition to mobile call termination by 2010.

Question 4: are there other options, not considered elsewhere in this consultation document, for removing the underlying causes of SMP?

MCI agrees with Ofcom’s analysis that none of the other forms of communication considered, such as SMS, call-back, etc. is a sufficiently close substitute for calls to mobiles to provide an adequate constraint. MCI is not aware of any alternative option, other than those considered, for removing the underlying cause of SMP.

Question 5: Do you believe, on balance, that a retail-minus approach to setting wholesale price could be advantageous?

MCI believes that Ofcom’s analysis of the shortcomings of relying on competition law to address the problem of call termination is sound. We also agree with Ofcom’s analysis that any move towards “fair and reasonable” charges in the hope of applying a lighter regulatory touch would be short-lived.

The “retail-minus” approach might deserve further consideration as it might help address some of the economic distortions resulting from the disparity between some retail charges and the mobile termination rate. In this regard, MCI particularly highlights the prevailing incentives to make mobile-to-mobile calls when fixed-to-mobile calls would be more efficient, and the demand to use GSM-gateways to reduce call termination charges.

A “retail minus” approach might therefore have appreciable merit in reducing the distortions in the relative prices of calls using different technologies compared with efficient values. It would also eliminate the need for the costly, time-consuming and burdensome regulatory resources devoted to GSM gateways policy and compliance, as well as the complex and often inadequate rules surrounding them.

However, whereas a “retail minus” approach would potentially eliminate some problems, and distortions, such an approach also presents problems. The most important drawback is the way it would affect MNOs’ incentives with regard to retail pricing. For example, MNOs could increase retail tariffs in order to earn more termination revenue. Competition between the MNOs would not prevent them doing so (except to the extent that they would face greater competition from fixed operators) because the incentives would apply to all of them to an approximately equal degree. If this occurred, the deadweight losses occurring from the over-pricing of certain retail services might cancel out the elimination in distortions between different technologies.

In considering a retail-minus approach, it would also be very important to carefully consider both the value of ‘X’, the ‘minus’ in the formula, and also the choice of retail tariff on which the price control was based. Further, MCI recommends that MNOs’ retail prices are taken into account when setting termination rates. Specifically, Ofcom should ensure that mobile termination charges are set at the lower of the LRIC estimates and the “retail minus” level.

Question 6: Do you agree that asymmetric regulation of voice call termination, which is applied only to termination on 2G networks, will cease to be effective as the proportion of calls terminated on 3G networks grows?

MCI believes the asymmetric regulation of voice call termination on 2G and 3G networks is wrong in principle and against the principle of technology neutrality enshrined in the EU Directives. Furthermore, call termination on both types of network have the same “calling party pays” properties and operate in the same market. There is therefore no valid argument for regulating them differently.

Question 7: do you believe that asymmetric regulation of mobile voice call termination, which applies only to termination on 2G networks, will create material incentives to terminate calls on 3G networks? If so, how easily could MNOs develop the technology necessary to follow these incentives?

Asymmetric regulation will create incentives to terminate calls on 3G rather than 2G networks. MCI is unable to comment on how easily the technology can be developed to achieve this. However, technology is not the only means of increasing the volume of calls terminated on 3G networks: higher termination revenues will create incentives for MNOs to price and promote 3G services in preference to 2G. See also our comment above.

Question 8: would it be reasonable to require that charges for mobile voice call termination (2G or 3G) are no higher than the cost-based charge for the more efficient form of termination? What are the risks and advantages of this?

MCI believes that, in general, charges should be based on forward looking costs using most efficient technology. To do otherwise would be to encourage and reward usage of inefficient technologies and practices.

Question 9: On what basis could a single charge control, to apply to both 2G and 3G voice call termination, be calculated?

Ofcom’s current project of modelling 2G and 3G networks together appears to be the correct approach. We recommend, however, that Ofcom considers appointing different consultants from those employed previously to allow a “second opinion” on the levels of charges calculated. We recognise that this is too late for the current project, which we regard as a missed opportunity. This does not, however, rule out using different consultants for future projects, or to cross-check the work currently being conducted.

Question 10: Should mobile termination of mobile originated calls be subject to lighter regulation than mobile termination of fixed network originated calls? If so, what form might that regulation take?

MCI believes that it is possible that the combination of approximately balanced call flows and similar costs structures, could lead to an efficient bargaining solution. However, there is a risk that a bill-and-keep solution, which would lower the marginal cost of off-net calls to operators, would encourage the inefficient substitution of mobile-to-mobile calls for fixed-to-mobile calls. This is not a certain result as it is unlikely to be in the mobile operators’ joint interests, but safeguard measures should nevertheless be applied. A non-discrimination condition, preventing mobile operators from charging different rates to fixed and mobile operators is one possible solution (although this would be equivalent to regulating fixed-to-mobile and mobile-to-mobile rates in exactly the same way). The retail-minus approach described under Question 5 above would also prevent this problem from emerging.

Question 11: is it appropriate for Ofcom to forebear from considering the imposition of regulation on termination of data services?

At present, MCI has no strong views on the regulation of termination of data services. However, we will be watching the market closely, especially for the emergence of separate markets for fixed-to-mobile data services made under calling party pays conditions.

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