Wholesale mobile voice call termination

Market Review

Volume 1 – Executive summary

Consultation

Publication date:	1 April 2010
Closing date for responses:	23 June 2010

Executive Summary

1.1 When fixed and mobile operators offer their customers the ability to call UK mobile numbers, they pay mobile communications providers a wholesale charge to complete those calls. The rates that operators pay are called 'mobile call termination' (MCT) charges or more commonly 'mobile termination rates' (MTRs).

1.2 On 31 March 2011, the rules which limit MTRs will expire. We are conducting a market review to consider what rules, if any, should apply after that time. This consultation sets out our proposals for a new MTR regime, running from 1 April 2011 to 31 March 2015.

1.3 The mobile sector is changing, in ways that are relevant to this market review. Mobile services connect a growing number of users to the internet, and users are as likely to send messages as to make telephone calls. These changes affect the question of what MTRs are likely to lead to the best outcomes for consumers, and whether regulation is needed to achieve this.

1.4 In our earlier consultation (published on 20 May 2009), we sought views on different approaches, including potentially radical reforms such as removing all rules on call termination or requiring that mobile call termination be priced at zero (termed 'bill and keep'). In this consultation, we explain why, having considered the options, we think that capping MTRs, based on some measure of cost, will lead to better outcomes for consumers than these alternative approaches.

1.5 In addition, European regulators have been debating the merits of different approaches to regulating MTRs. In May 2009, the European Commission (EC) issued a Recommendation calling for MTRs to be limited to the incremental costs of providing call termination to other communication providers (a method called, in this consultation, pure long-run incremental cost (pure LRIC).[1] The closest alternative to pure LRIC is to include additionally a mark-up for joint and common costs, such as the cost of the spectrum used by the network – an approach called 'LRIC plus' or LRIC+).[2]

1.6 Previous MCT charge controls have been set using LRIC+. In our model, if we set charges using pure LRIC, by 2015, MCT charges will be one third of the charges calculated on a LRIC+ basis. A pivotal question in this review is: should we follow the EC's Recommendation and adopt pure LRIC?

1.7 Consistent with our primary duty, in deciding which method to use to set charges, we have considered how each approach affects different consumer groups.[3] We have also undertaken an impact assessment to consider how other stakeholders, including fixed and mobile communications providers, may be affected by our proposals.

[1] Pure LRIC only allows for long run variable costs to be recovered, and excludes common costs. For more information, see section 7.
[2] Long-run incremental cost (LRIC) is a method of understanding the incremental cost to an operator for providing a service, compared with not providing that service. LRIC+ includes an allocation for the fixed and common costs for the service, so that the cost of a minute of traffic on a particular network segment is the same for all services carried across that segment.
[3] Ofcom's primary duties are to further the interests of citizens, and of consumers, in relation to the matters where we have regulatory responsibility. Annex 6 has more information on the regulatory regime and our general and specific duties.

1.8 Our approach is also consistent with the feedback from our earlier consultation, in which major stakeholders were unanimous that some form of cost-based charge control was needed, with debate polarised between whether LRIC+ or pure LRIC would deliver the best outcomes. Other methods such as bill-and-keep or capacity-based charging were seen as impractical or potentially problematic if introduced (or else, options to return to in the long term).

1.9 This consultation sets out our proposals to:

1.9.1 Define as separate markets each market for all calls to a given UK mobile number range for which a communications provider can determine the termination rate.[4]

1.9.2 Designate each undertaking that has been allocated one or more of these number ranges as having significant market power with respect to the (wholesale) market for the service of terminating calls to that range. This recognises both the ongoing technological developments and the commercial reality that control of the number range provides the mechanism by which pricing power is exercised in relation to calls to 07 numbers. Applying this approach will mean that more than 50 mobile communication providers (MCPs) are designated.[5]

1.9.3 Regulate directly the termination charges of the four[6] MCPs which operate fully-deployed national mobile networks. After a single-year transitional period, we anticipate the same rate being set for all four networks (an outcome termed 'symmetry').

1.9.4 Require other MCPs to provide call termination on fair and reasonable terms. We expect that this will result in commercial agreement to exchange traffic in both directions at the same charge as the symmetrical rate that applies to the four national MCPs (an outcome termed 'reciprocity'). Reciprocity is also consistent with the approach that we have taken in resolving a number of disputes previously, and, without prejudging the outcome of future disputes, we think that these decisions help provide regulatory certainty that, in many – perhaps almost all – cases, reciprocity is a fair and reasonable arrangement for MCT. This mirrors the arrangements that already apply in relation to fixed call termination.[7]

1.9.5 Use pure LRIC to set the charge control. We propose a four-year glide path of rates, based on a maximum average rate calculated using the pure LRIC of providing call termination at the end of our charge control period. This will lead to MTRs falling from 4.3ppm in 2010/11 to 0.5ppm by 2015 (in 2008/9 prices). The major factors behind this decline are:

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[4] In the 2007 charge control, the market definition was linked to specific mobile access networks and therefore excluded calls that, for example, went to voicemail even if these calls were charged exactly in the same way.

[5] In the 2007 charge control, only the five national mobile network operators (MNOs) were designated as having significant market power, and smaller MCPs were not subject to ex ante regulation

[6] In September 2009 Deutsche Telekom and France Telecom announced their intention to merge their UK MCPs, T-Mobile UK and Orange UK. On 1 March 2010, the merging parties received regulatory approval from the European Commission for the proposed merger. This merger has now reduced the number of national MCPs in the UK from five to four.

[7] In the 2007 charge control, for mobiles there was no fair and reasonable requirement on smaller providers, which led to a number of disputes between large and small providers covering MTRs for smaller operators.

- o very large increases in data volumes, reducing the proportion of costs attributable to voice;
- o decline in the cost of network equipment, as 3G technology becomes more established; and
- o the removal, as a result of moving to pure LRIC, of the contribution by MCT charges to the joint and common costs of the network. (The equivalent calculation for LRIC+ would see a maximum average charge of 1.5ppm by 2015.)

Table 1 - Proposed MTRs (pence per minute - 2008/09 prices)

	2010/11	20011/12	2012/13	20013/14	2014/15
Vodafone / O2 / Orange / T-Mobile[8]	4.3	2.5	1.5	0.9	0.5
H3G[9]	4.6	2.5	1.5	0.9	0.5
Other Mobile Call Providers	Set on the basis of being fair and reasonable				

1.9.6 Limit the frequency and size of changes MCPs can make to their MTRs. This will significantly limit the scope for a practice called 'flip-flopping', where rates are varied by time of day to exploit flexibility in the way that the previous regime worked. Left unchecked this practice could allow MCPs to force others purchasing MCT to pay more, in aggregate, than the rates intended to be set as an upper limit in the previous charge control. This practice also forces competing operators to incur extra costs, as the MTRs are frequently changed by significant amounts.

1.10 We propose using pure LRIC method to set regulated rates (over LRIC+) in the light of economic evidence, the legal position and other relevant evidence. In particular:

1.10.1 no single argument or set of economic arguments have been found to strongly support one approach over the other – both have their merits and limitations;

1.10.2 the distributional impacts of pure LRIC as compared to LRIC+ on consumers are not so significant to be a basis for not adopting pure LRIC; and

1.10.3 we set out our view that, given the decision by the EC to recommend a particular approach across all EU Member States, we ought to adopt the EC Recommendation unless there are substantive reasons not to do so.

1.11 We believe that the overall outcome for consumers of adopting pure LRIC will be positive, and the risk of harm to consumers overall or on specific groups of consumers who are vulnerable is low.[10] We expect that, as part of an overall

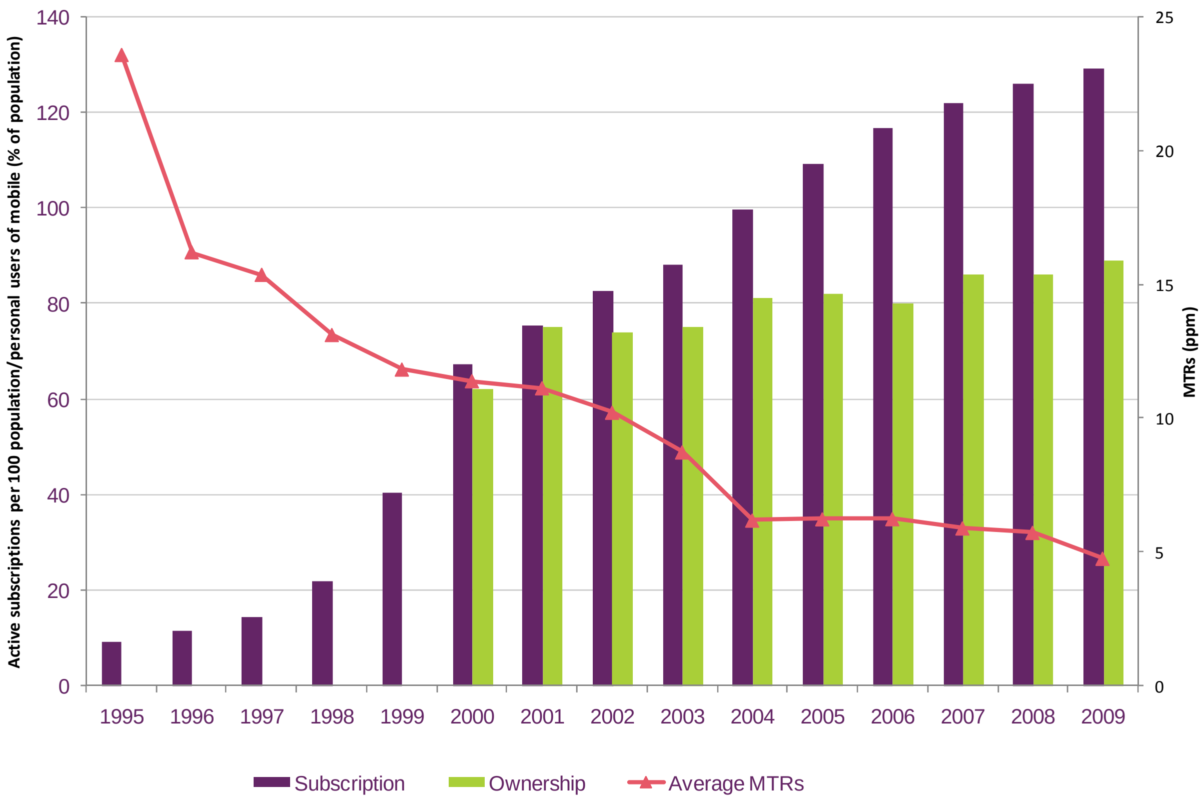
[8] 2G/3G MCPs
[9] 3G Only MCP
[10] This issue is discussed further in section 9

reduction in MTRs, the move to pure LRIC will reduce call prices and promote competition, furthering the interests of consumers.

1.12 Our proposals continue a long term trend during which time MTRs have fallen from more than 23ppm in 1995 to less than 5ppm today as shown in the chart below. During that time mobile penetration has increased enormously, prices have fallen considerably and MCPs have invested heavily in delivering new services, such as mobile broadband.

1.13 As with previous MTR charge controls, the mobile industry will continue to face steady and sustained reductions in MTRs. We anticipate that the market will be capable of adapting to these changes, which will be implemented over four years and which are broadly in line with previous trends. As the market adapts, we believe that further reductions in termination rates will promote competition, the development of innovative tariff packages and the growth of genuinely converged fixed and mobile services.

Figure 1 – MTRs, subscription and ownership



Source: Ofcom

1.14 Following the publication of this consultation, we plan to conclude the market review with a statement in the second half of 2010.