Bringing it all together

Wholesale mobile voice call termination

BT's response to Ofcom's preliminary consultation of 20th May

29 July 2009

BT welcomes comments, which should be sent by e-mail to
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Executive Summary

It is axiomatic that regulation needs to adapt to changing markets, and the mobile sector is certainly one in which change appears to be a notable feature. But the particular market Ofcom is examining here – voice call termination on mobile networks – is one that has remained resolutely unchanged since the inception of mobile networks in the mid-1980s. The only change has been exactly how many unearned millions of pounds this service has cost the UK consumer from year to year - last year, the mobile operators received over £750 million from landline customers alone, despite over a decade of formal price regulation.

The mobile network operators have exactly the same level of market power (that is, a monopoly) in their termination markets as they had in the 1980s, when they were able to charge as much as 30 pence per minute for terminating a call on their networks. That 30 pence is now a seemingly more reasonable 5 or 6 pence. But that reduction has taken almost 20 years and has been brought about *entirely* by repeated regulatory intervention, not through market forces. Even Ofcom's original 2011 target of approximately 5 pence per minute was deemed too high on appeal, and the Competition Commission, working within the confines of the existing Ofcom methodology, took a further penny off the target. But this is still far too high. And the European Commission thinks so too.

Mobile networks will be charging about 4 pence per minute by 2011. Fixed networks will be charging around 0.3 pence for the same service. If the costing methodology was harmonised across fixed and mobile platforms, we believe customers would be paying one penny a minute or less for terminating calls on mobile networks.

The detriment to consumers from excessive termination rates is described by Ofcom in its consultation. Unreasonably high rates:

- create an artificial price floor for all communications providers, thereby constricting competition, keeping prices high;
- prevent the correct signals being sent to users about which services are most efficient;
- distort the market by advantaging larger networks over smaller networks; and
- disadvantage in particular those who call wholly or mainly from a fixed network.

Any claim that forcing lower mobile rates will actually increase consumer detriment should be disregarded – the incumbent operators have cried wolf before. Properly controlling excessive rates will lower market entry barriers (high already given spectrum limitations) and enable both fixed and other mobile operators to compete with the main mobile players, in turn delivering better customer deals.

So there is absolutely no doubt that Ofcom must continue to regulate these markets. While Ofcom should continue to explore with the industry some of the more radical options going forward, its responsibility for the next period from 2011, should be to ensure termination rates are lowered significantly. Only when they have reached a much more reasonable level can Ofcom contemplate a major regime shift in regulation. Ofcom should therefore follow the recommendation of the European Commission in that it should exclude mobile coverage costs, unavoidable business overhead costs and retail commercial costs from being imposed on customers calling mobile networks. A one-off cut to bring rates down significantly in 2011 should be considered, with further real reductions being required year-on-year thereafter.

Finally, we would draw Ofcom's attention to the fact that there are now just 20 months before the current charge control expires. BT is concerned that any new control from April 2011 is not subject to any delay. We commend Ofcom to complete the market review process expeditiously, avoid a 'rollover' as happened in 2006/7, and thereby deliver the optimum welfare gain to consumers in a timely manner.

This response has three sections:

Section 1 answers Ofcom's primary questions on the approach it should take to regulating mobile termination;

Section 2 deals with the market criteria, including the important question of the consumer benefit to be derived from regulating these markets; and

Section 3 addresses Ofcom's options in detail.

1. *Ofcom's Policy Approach*

Ofcom draws out three key questions in the first Section of its Consultation[1].

Q6.1 Should our policy approach to regulating MCT change? For example, given the possible benefits, should we adopt a policy of reducing termination rates as far and fast as we reasonably can, within the boundaries of sound economic policy, and whilst recognising underlying cost differences? If our policy approach did change, what do you think are the relevant factors for us to consider in deciding on the best future policy to regulating MCT?

Ofcom should continue its policy of reducing mobile termination rates as far and as fast as necessary to ensure consumers are not paying more than they should.

Mobile termination rates have been set at levels that far exceed the incremental cost of terminating calls. This is distorting competition between fixed and mobile operators and, above all, penalising ordinary fixed phone users who have, to all intents and purposes, been taxed to subsidise the mobile phone companies.

A key difference between fixed and mobile termination rates is that fixed termination rates have been set to recover just the incremental costs of carrying a call to the called party whilst mobile termination rates also recover some of the basic costs of providing mobile phone users with *access* to the mobile phone network (such as the cost of spectrum licences, the basic costs of laying out the network to provide signal coverage and even, in some countries, a share of sales and marketing costs and handset subsidies). Fixed customers pay all the fixed access costs through line charges, so BT strongly supports the view (as expressed by the European Commission) that they ought not to be required to pay towards mobile *access* costs through high charges to call mobile phones.

As the Commission pointed out when describing the mobile operators' 'classic monopoly behaviour' earlier this year[2], mobile termination rates remain out of all proportion to both operator costs and charges for comparable services. They are on average ten times higher (and in the UK 15 times higher) than fixed termination rates, and four to five times above the cost of completing the call.

Ofcom should therefore ensure that mobile call termination rates are reduced to the appropriate economic level in order to establish an equitable converged market place and deliver optimum benefits to all end-users. An ongoing price control, with a one-off cut at the start of the control period, is still the best way to achieve this until such time as market conditions allow a different approach. We expand upon this in Section 3.

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[1] paragraph 1.18, where these questions are numbered Q1.1, Q1.2 & Q1.3.

[2] Neelie Kroes, European Commissioner for Competition Policy "*Cutting the price of phone calls – new termination rules*"; remarks at Brussels press conference; 7 May 2009
http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/09/218&format=HTML&aged=0&language=EN&guiLanguage=nl

The current regulation whereby the mobile network operators (MNOs) are required to meet a target average charge (TAC) across an annual period allows operators a substantial degree of flexibility to vary termination rates and to change them frequently. With a minimum of five terminating operators and up to three time-of-day segments, this results in a plethora of possible retail call prices for anybody who calls a mobile, exacerbated by the general lack of transparency given to end-users. In noting that the proliferation of calling tariffs is a source of confusion for consumers, we suggest that Ofcom should consider whether a TAC is the best approach or whether a single prescribed charge might not provide a better deal for the consumer.

Finally, we would suggest that the next stage in Ofcom's process needs to have come to a final decision as to the appropriate methodology to be adopted. There will simply not be time for further debate – and we envisage there being plenty of scope for vigorous discussion of the detail of any chosen methodology as it is. While Ofcom is following a similar timetable to the one followed in 2005, much of the debate then about alternative regulatory approaches had already taken place in the context of the Telecommunications Strategic Review (TSR)[3]. Any regulation is likely to be in consumers' interests and we would not wish to see any benefit delayed simply because insufficient time had been allowed for the checks and balances in the regulatory system to operate.

Q6.2 Are there additional options (other than the six set out in this consultation) that we should consider? If so what are they and what advantages/disadvantages do they offer?

The six options Ofcom identifies appear to cover the full range of reasonable approaches to the call termination markets in question. Given the international research Ofcom has carried out, it seems unlikely that Ofcom has missed anything significant. Consideration of any additional options would add delay to the market review process and should therefore only be contemplated if any appears to offer a particularly attractive solution.

Q6.3 Do you agree with our preliminary views set out for each of the options? If not, what are the additional factors that we should take into consideration, and why are they relevant to our analysis?

We have provided a separate assessment of the options in Section 3.

[3] And even so, the Final Statement was published with just four days remaining before the new controls were due to come into effect.

2. Market Criteria & Consumer Benefit

In Sections 3, 4 and 5 of the Consultation, Ofcom identifies the markets for mobile voice call termination, assesses the levels of Significant Market Power (SMP) therein and concludes that there is potential for consumer harm arising from the exercise of such SMP.

BT looks forward to reviewing in due course to Ofcom's more comprehensive market assessment, but we would offer the following responses to Ofcom's specific questions, together with some important wider considerations on consumer detriment and benefit.

2.1 Market Definition

Q3.1 Do you agree with our preliminary view on market definition? Has anything changed, or is anything likely to change within the period of the next review, which would materially impact on the definition of the market(s)?

As primarily an originating operator seeking mobile call termination, we would naturally welcome any substitutes to terminating calls on each of the mobile networks. It remains steadfastly the case, however, that mobile call termination is a distinct service offered by each of the MNOs exclusively. We therefore agree with Ofcom's view and do not believe that any of the emergent technologies mentioned by Ofcom will have any effect on the definition of the market within the period of the next review[4].

2.2 Market Power

Q4.1 Do you agree with our view [of market power]? Or are there other developments, not considered elsewhere in this consultation document, for potentially removing the underlying causes of SMP?

Ofcom is right to monitor market developments which might have the effect of introducing competition into the MCT market. However, we are not aware of any which have a material impact on the market power of the MNOs in call termination, extant or potential. We note that as recently as July 2009, the Court of Appeal[5] dismissed H3G's case which had claimed that H3G does not have SMP in the market for MCT.

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[4] The most likely shift in market definitions is the convergence between fixed and mobile markets, but as Ofcom has noted in its recent fixed market reviews, the evidence remains insufficiently strong that fixed and mobile calls are in the same economic market and therefore that fixed termination acts as a substitute for mobile termination. In the unexpected event that Ofcom's review of the mobile termination market arrives at a different conclusion from this, we would see a need for Ofcom to reassess its regulation of the relevant fixed markets.

[5] *Hutchison 3G UK Ltd vs Office of Communications*, Case No C1 2008/1931, Court of Appeal (Civil Division) 16 July 2009 [2009] EWCA Civ 683

2.3 Consumer Impacts

Q5.1 What are likely to be the main sources of detriment to consumers of excessive termination rates in the period 2011 to 2015?

Ofcom has correctly identified the main theoretical sources of consumer detriment:

- economic inefficiency;
- distortion of consumer choice; and
- competitive impacts.

We estimate the annual actual financial detriment to fixed-line consumers alone to be of the order of £600m[6]. The European Commission estimates that eliminating price distortions in termination between phone operators across the EU will save business and household customers at least 2 billion euros in 2009-2012. The Commission, in its campaign to push through reductions in mobile termination rates, has positioned this as being only the short-term gain, saying "…in the mid-to-long-term, the overall gain to society as a whole resulting from increased competition will be much greater" [7].

Excessive termination rates mean that the prices of calls to mobile phones, at least from fixed lines, will remain a long way above the incremental costs of handling these calls. This means that from fixed lines, consumers and businesses face misleading price signals; they would be paying much more than cost. Understandably, some fixed-line customers will be deterred from calling mobiles although they would have been prepared to pay the genuine additional cost. This will then give rise to missed contacts and losses of the benefits (potentially to both parties) that would have occurred had the call taken place.

However, given that mobile termination is deemed to be of higher cost than fixed termination, it must also be the case that origination costs more on mobile networks than it does on fixed networks. And yet we find lower retail prices for mobile-to-mobile calls compared to fixed-to-mobile calls. This inconsistency indicates there is a competitive distortion at play: that is, that excessive profit on termination is being used to cross-subsidise the mobile-to-mobile retail price.

Fixed-only customers are clearly disadvantaged by excessive termination rates for calling mobiles. Customers who have both fixed lines and mobiles may face both misleading absolute prices <u>and</u> misleading relative prices and may therefore make fewer calls or make some of them from the network with higher marginal underlying costs.

For retail consumers, BT's retail arm wants to offer all-inclusive packages where customers pay a set price and have the peace of mind that all calls will be covered, including those to mobiles. Current termination rates make that

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[6] based on relevant costs for mobile call termination being 1p per minute.

[7] Neelie Kroes, *ibid* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/09/218&format=HTML&aged=0&language=EN&guiLanguage=nl

impossible. Bearing in mind the level of mobile termination rates, it's easy to see how inexpensive calls to mobiles could become if termination rates were reduced to around a penny or less. Price signals would more closely reflect underlying incremental costs and encourage more calls to mobile phones. Overall, this will increase the amount of communication, benefiting both consumers and the fixed and mobile industries. The increase in consumer welfare is highlighted by the European Commission as the key rationale behind its Recommendation[8].

There will be other respondents who will claim that lower termination rates will lead to more consumer detriment rather than less. The same respondents may also have claimed, in response to Ofcom's recent Mobile Sector Assessment for example, that the mobile market is fiercely competitive. If such is indeed the case, Ofcom should have little to worry about, as firms will compete aggressively for customers and thereby squeeze out any consumer detriment arising from mobile pricing. So we think Ofcom should take claims of increased risk of detriment with a pinch of salt, as it has done in the past when similar claims have been made, for example, at the time of 2002 Competition Commission (CC) investigation into this market. The CC's accounts[9] of the mobile network operators' (MNOs) concerns make interesting reading:

As part of a set of pessimistic scenarios, the MNOs claimed that reductions in MTRs would result in:

- subscription prices rising;
- outgoing call prices rising;
- total call volumes falling;
- prepay handset prices rising (possibly by £15-£20);
- millions of marginal customers leaving;
- penetration rates falling.

One MNO predicted that some 25% of its customers would give up their mobile phone if other (non-termination) prices were to rise to make up for lost termination revenues. One mobile operator thought that the 'strong likelihood' of a contraction in the mobile market would lead to a stifling of innovation and lower incentives to invest in enhancements to UK mobile services. Another MNO described the effects of a one-off cut or a severe price cap as risking a 'downward spiral of investor confidence', with particularly deleterious consequences for pay-as-you-go customers. It went on to suggest that a severe price cap would put at risk the development of 3G services, delaying or damaging the prospects of new broadband services.

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[8] see the Commission Staff Working Document accompanying Commission Recommendation 2009/396/EC of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU: *Implications for Industry, Competition and Consumers*, Sec (2009) 600, from page 26 onwards: http://ec.europa.eu/information_society/policy/ecomm/doc/implementation_enforcement/article_7/working_doc.pdf

[9] *Vodafone, O2, Orange and T-Mobile: Reports on references under section 13 of the Telecommunications Act 1984 on the charges made by Vodafone, O2, Orange and T-Mobile for terminating calls from fixed and mobile networks* http://www.competition-commission.org.uk/inquiries/completed/2003/vodafone/index.htm

As it transpired of course, the MNOs were ordered to reduce MTRs significantly: a one-off cut of 15% followed by annual reductions of 14 or 15 points below the rate of inflation. However, call volumes continued to rise (and at a very similar rate to the preceding period); penetration continued to increase, reaching saturation (100%) in 2004; and the price of a basket of mobile services fell by over 25% between 2002 and 2006. One or two mobile operators did seek to reduce their subsidy on handsets, only to find that they had to reinstate the subsidy in order to be competitive.

Indeed, Ofcom was able to publish its 2008 Mobile Sector Assessment[10] describing the UK as having 'gone mobile', with half the money spent on telecoms being spent on mobile services, penetration levels exceeding 120%, with most people on pre-pay, and falling prices. No particular investment problems were revealed and there were satisfactory levels of innovation. Indeed, Ofcom is sufficiently confident about the sector that it has decided not to carry out any further assessment[11], despite BT's suggestion that competition in the sector could be improved[12].

In this context, we note the EU's Competition Commissioner's remark that "in terms of how operators will adjust to the new competitive environment, we believe … that those who offer efficient and innovative services will be fine. The [EC] Recommendation clarifies that phone companies are not entitled to rip-off phone users."[13]

We would also like to draw attention to the possible consolidation taking place within the mobile sector and suggest that Ofcom will need to ensure that consumers are not adversely affected as a result. In particular, any consolidation (be it through network sharing or more fundamental merging) is likely to strengthen the existing oligopoly and could impede the potential for market efficiency improvements. The consumer should share in the gains from greater scale economies and regulation can help to ensure these are not appropriated by the mobile industry.

Finally, the huge public response to the ***Terminate the Rate*** campaign (www.terminatetherate.org) with nearly 70,000 people signing the petition, is evidence that consumers are recognising that high MTRs have a direct impact on retail prices and that they feel they are being exploited in this market. Organisations championing the campaign include *Age Concern & Help the Aged*, the *RNID*, *for dementia*, and *Carers UK*, along with two major Trades Unions, the *Federation of Small Businesses* and *moneysupermarket.com*.

Given that Ofcom has placed the consumer at the heart of its considerations, this is a clear signal of the direction in which Ofcom should be moving, and of a widespread and ineluctable desire for an end to excessive termination rates.

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[10] "*Mobile Citizens, Mobile Consumers*" Ofcom August 2008: http://www.ofcom.org.uk/consult/condocs/msa08/

[11] see Ofcom's July 2009 consultation "*Mostly Mobile*": http://www.ofcom.org.uk/consult/condocs/msa/

[12] BT's response to "*Mobile Citizens, Mobile Consumers*", 6 November 2008: http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Consultativeresponses/Ofcom/2008/Mobilecitizens/index.htm

[13] Neelie Kroes, *ibid*

3. Ofcom's Options

This consultation has started a useful debate about the form regulation should take and the methodology that should be employed. Ofcom's range of options has been suitably extensive, and we have considered each of them on their respective merits. However, we believe the time is not right for any of the more radical proposals to be tried in this market. As Ofcom found when it started a similar process in 2005 (which contemplated many of Ofcom's current options, albeit under different guises or names) the appetite for major change amongst both the industry and/or its customers is often poor while there remains scope to adjust existing mechanisms to achieve the same end without the risk of large-scale disruption.

BT therefore recommends that, when Ofcom conducts the next stage of its market review later this year, and assuming it finds SMP in this market, it proposes a replacement control which differs from the current control only in respect of the costs allowed to be included in the rates for call termination. That is, consistent with the European Commission's Recommendation, the methodology for establishing the relevant termination charge should exclude mobile coverage costs, unavoidable business overhead costs and retail commercial costs.

We estimate this would reduce mobile termination rates to around the one-penny-per-minute mark. This would be consistent with the EC's requirement for mobile termination rates to be substantially reduced (to as low as 1½ cents per minute) across the EU by the end of 2012.

We have set out below (paragraph 3.2) our views on four options that we consider not to be fit-for-purpose for the forthcoming control period (though each has merits which may make them suitable candidates at some point in the future). But first, we put forward our own view as to the methodology Ofcom should adopt from 2011.

3.1 Equitable regulation for a converging market

Ofcom has identified Long-Run Incremental Cost (LRIC+) and Long-Run Margin Cost (LRMC) as separate options, but they share many of the same features. The important point of the EC Recommendation is rather that it calls for the exclusion of costs that are not driven by traffic volumes, mobile coverage costs, unavoidable business overhead costs and retail commercial costs[14] (as well as the costs of the handset and the SIM card). BT agrees that these costs should not be imposed on customers calling mobile networks.

Both LRIC+ and LRMC impose a similar regulatory burden on stakeholders, as each requires network cost modelling.

Both methodologies also seem to have a similar level of risk of error (and dispute). We would not, however, seek to place too much emphasis on this.

[14] see the annex to Commission Recommendation 2009/396/EC of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU: *Principles for the calculation of wholesale network termination rates in mobile networks*.
http://ec.europa.eu/information_society/policy/ecomm/doc/implementation_enforcement/article_7/recom_term_rates_en.pdf

It is true that the last price control (based on LRIC+ modelling) was appealed, but the Competition Commission did not find the network cost modelling to be deficient[15]. Indeed, it is not clear that the risk of regulatory error and/or dispute is any greater for these options than for the other four approaches Ofcom describes - and indeed Ofcom makes the point that LRIC+ is a well understood, reliable methodology which has been upheld on appeal. In effect, we do not see this as a consideration which weighs against either LRIC+ or LRMC, or which differentiates the two.

BT believes the most important distinction between LRIC+ and LRMC, and one that any regime must in future address, is that LRIC+ as applied to mobile termination has until now not been based solely on traffic-sensitive call costs, whereas the clear intent of the EC is that LRMC should *only* include traffic-sensitive costs.

This is important as fixed termination rates exclude all non-traffic sensitive costs, and the disparate treatment of the two types of termination has led to a distortion of competition. Fixed customers, when they call a mobile number, contribute to what the EC refers to as the 'coverage' costs of the mobile operators, whereas mobile customers calling a fixed number make no such contribution. This disparity seems to have arisen because fixed customers pay for their access costs, whereas there is no equivalent line rental charge for mobile customers[16].

BT therefore believes that Ofcom should at a minimum, ensure that MTRs exclude all access costs which represent network coverage costs and so achieve the harmonisation of approach across different platforms.

On what may be a related issue, BT also notes that Ofcom recognises that the magnitude of common costs under LRIC+ in absolute terms is greater for mobile than for fixed.[17] The Consultation does not, however, offer any explanation as to why this has arisen. Clearly, one explanation would be that some non-traffic sensitive costs are included in mobile termination rates but not in fixed termination rates. We therefore suggest that, whatever methodology is finally chosen, this is an area worthy of further examination. In particular, in setting MTRs and FTRs, it is important that Ofcom makes clear why there are differences in the magnitude of common costs and confirms that these are to be removed unless they result from genuine differences in fixed and mobile networks (rather than differences in approach to cost modelling).

Finally, BT is not convinced that changing the size of the increment over which costs are measured is necessary. As Ofcom states[18], the choice of marginal rather than incremental costs suggests that LRMC might be based on a much smaller output (volume) increment. The key point is, surely, that MTRs should be non-discriminatory in the sense that there is no difference between the notional price of internal purchase and external purchase. This will tend to support a marginal approach to costing rather than an average cost approach, and thus again support the exclusion of mobile coverage costs, unavoidable

[15] It found that that the 3G spectrum value was incorrect and that an additional allowance for network externalities should no longer be included in MTRs.

[16] This may reflect the fact that none needs to be levied, given the level of MTRs.

[17] see paragraph 6.108.4

[18] see paragraph 6.111

business overhead costs and retail commercial costs. However, in terms of the specific increment, one that covers both internal and external sales (that is, self-supply and termination for third parties), seems the most appropriate as this will ensure non-discrimination.

3.2 Ofcom's other options

3.2.1 Deregulation

While BT would naturally embrace any proposal to deregulate its own equivalent service, Ofcom is right to be cautious in its approach in the mobile sector. As the Consultation notes, there is a very real risk that, in the absence of regulation, the mobile network operators will raise rates to higher levels, to the detriment of consumers and potential entrants.

One need only examine the behaviour of the MNOs when call termination on 3G networks was unregulated before the new charge control came into effect in April 2007. During much of 2006, the MNOs sought to charge on average, *2½ times* the regulated 2G rate for termination of exactly the same type of calls on 3G networks. A subsequent appeal at the Competition Appeals Tribunal resulted in a requirement on the MNOs to refund around £60m to their interconnecting wholesale customers. There can therefore be no doubt that the risk that rates will be set too high, in the absence of regulation, is a real one.

It seems likely that the MNOs will put forward a view that the waterbed effect in the mobile sector is complete, such that excess returns in call termination will be competed away in origination and other markets. However, as Ofcom reports in Annex 6, the waterbed effect is "probably incomplete". It certainly cannot be relied upon to justify a withdrawal of regulation at this time.

As long ago as 2005, Ofcom asked the mobile industry to "…*renew its efforts to identify a change to market structures which would lead to a competitive market from which all regulation may be removed, and which would be beneficial to consumers*."[19] Until such changes are forthcoming, we cannot see a justification for removing regulation.

Furthermore, as each MNO is likely to be found to have SMP in its respective wholesale call termination market, deregulation would seem to be ruled out as an option under the European regulatory framework.

Nevertheless, as a cross-market deregulatory approach has now been put on the table, we think it may be useful for Ofcom to carry on that debate as a separate work-stream for more detailed consideration at the fixed and mobile market reviews in the next decade.

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[19] Paragraph 1.8 in " *Wholesale mobile voice call termination: Preliminary consultation on future regulation"* Ofcom June 2005
http://www.ofcom.org.uk/consult/condocs/termination/wholesaleprelim.pdf

3.2.2 Capacity-based Charging

Ofcom's description of this option (CBC) lacks sufficient detail to enable anything other than a very high-level and theoretical assessment of its merits. Certainly, the parallel that Ofcom draws with the internet interconnection market can only be observed at a superficial level and fails to take account of the wholly different ways in which the markets have developed, their very different characteristics, and the diversity of the services being offered.

But most importantly, and as Ofcom recognises in paragraph 6.131, CBC still requires an assessment of costs to be made – which would be based on one or other of the methodologies Ofcom has already set out separately. CBC is therefore an option that *appears* to offer a lighter-touch way of regulating termination, but retains exactly the same need to establish relevant costs and, as with pence-per-minute charging, requires usage to be monitored and measured. It therefore seems to require no lower level of administration than the existing system, and possibly would require *more*. And while CBC at the wholesale level might dovetail nicely with moves at the retail level away from pence-per-minute charging, the latter is certainly not reliant on the former, as can be seen with the proliferation of 'all-you-can-eat' packages.

In addition to the practical hurdles Ofcom mentions in paragraph 6.129 (such as the requirement for all-operator co-operation and the sheer costs of implementation), there are risks to existing sub-markets. For example, service providers whose business models are currently based on pence-per-minute Number Translation Services (NTS – such as premium rate services, PRS) would need to find an alternative micro-payment system or they would cease to exist. Disruption to other markets, such as transit, and to investment models, would also need to be assessed and addressed. The economic incentives that CBC would promote may require some analysis in order to safeguard against inefficiencies, particularly in relation to over-booking of capacity and traffic handover policies.

BT considers CBC to be an appealing theoretical option, but one difficult to envisage in the real world, and certainly not in less than two years' time.

3.2.3 Mandated Reciprocity

BT agrees with Ofcom's preliminary assessment of this option. Mandated Reciprocity (MR) has two very strong arguments in its favour:

- a single termination rate for voice calls provides a simple and clear regime for all voice providers, and removes the need to undertake detailed cost modelling of mobile networks; and

- it is consistent with a world of voice service convergence.

We note that reciprocity between fixed operators has been in place for many years and this has "reduced the 'temperature'" of this issue in the fixed call termination market. All suppliers receive the same (low) incoming call revenue (on a pence-per-minute basis) and can therefore compete at the retail level from an equal footing. We consider that low MTRs would also be good for competition between mobile operates as there would be far less concern about imbalances of traffic or about the implications for smaller scale operators (who tend to lose out when MTRs are high). It also directly addresses concerns about the burden imposed by regulation of the call termination market.

We also note that this regime seems to operate in the US where customers enjoy many of the types of inclusive package which we think would be of benefit to UK consumers.

We agree with Ofcom[20] that this option becomes particularly attractive as the technology used to provide both fixed and mobile services becomes increasingly similar. This largely turns on the issue of femtocell deployment and we therefore recommend that Ofcom seeks information for the MNOs about their plans in this area.

Ofcom also mentions that the option may well be challenging as there might be disputes and/or litigation around making such a "breakthrough" regime change. This is, again, clearly a matter for Ofcom to consider. BT would like to point out, however, that whilst the regulatory burden might be increased in the shorter term, this option holds the promise of a much simpler regime once the transitional phase has been completed.

One way to lessen the burden all round, might be for Ofcom to indicate its intention to move to MR well in advance of any such planned change. Unfortunately for consumers, the present Consultation may already be too late for this. The timetable imposed by the need to have any new regime in place by 1 April 2011 makes it almost impossible to achieve a meaningful regime change, as time would need to be allowed for any litigation to be completed. Mandated Reciprocity is therefore a relatively high risk option for Ofcom (and for UK consumers) for 2011. It may well be that Ofcom's best course of action is to plan for MR for a further control after the next one, especially as the costs of termination on fixed and mobile networks will reduce to an efficient (and more converged) level by this time if Ofcom adopts the EC Recommendation as we urge it to do. This is also the view supported by the European Commission, which considers that "reducing termination rates to an efficient level is an appropriate first step before other potential approaches may be introduced"[21] But once those reductions are on track for delivery, we would see Mandated Reciprocity as worthy of serious consideration.

3.2.4 Mandated Bill & Keep

BT considers that, although Bill and Keep (B&K) has a number of advantages, it is not likely to be the regime which best suits UK consumers when all implications are considered. We do appreciate that B&K is simple and, at a stroke, solves the problem of potential abuse of a dominant position by terminating operators. It is also likely to lead to innovation at the retail level, in

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[20] see paragraph 6.141.2

[21] Commission Staff Working Document accompanying Commission Recommendation 2009/396/EC of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU: *Explanatory Note*, Sec (2009) 599, page 31.
http://ec.europa.eu/information_society/policy/ecomm/doc/implementation_enforcement/article_7/explanatory_note.pdf

terms of the development of new types of call packages. It may well be the best of all the options to reflect (uninternalised) call externalities.[22]

However, B&K means that a service which costs operators resources to supply would be made free. This would create a disparity between price and any view of cost, and thus breaks the link between costs and prices – calls would become "hot potatoes" to be handed over as quickly as possible. Ofcom might therefore find itself forced into an intrusive regulatory prescription of where and how networks exchange traffic. This seems unlikely to lead to economic efficiency (as implied by Ofcom in paragraph 6.154). It is also likely to be unfair on certain operators where there is an imbalance of traffic and is really only appropriate where there is an approximate balance of traffic (that is, where operators who are allowed to terminate calls their customers originate for free, also provide in return the approximate same level of termination for other operators).

There are also a number of other issues which would need to be resolved were this option to be pursued. If termination is free, we would expect to see operators handing over calls for termination at the first available point of interconnection (as mentioned above), which would load costs on to the terminating operator. This is also likely to have adverse implications for the transit market (in effect, undermining the "paid for" market). Some rules to stop such practices would need to be devised, so that far-end handover was still rewarded.

The implications of B&K for the NTS regime and PRS regime would also need to be considered and it might be necessary for an alternative approach to micro-payments to be developed. As with Capacity-based Charging (see above), any move away from pence-per-minute charging would jeopardise some current NTS-based business models unless an alternative mechanism were instigated across all operators.

Finally, we would point out that although there would be no need for terminating operators to record calls for billing purposes, the keeping of records might be needed for other purposes (legal or operational), so record-keeping and the associated costs may not be avoidable.

In summary, BT considers that there are likely to be important differences between *low* termination rates and *free* termination rates, and that the full case for the latter has not yet been made.

BT Group plc
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[22] as reported by Ofcom in paragraph 6.149