Virgin Media
Communications House
Bartley Way
Bartley Way Business Park
Hook
RG27 9UP

Paul Jacobus
Ofcom
Competition Group
4th Floor
Riverside House
2A Southwark Bridge Road
London SE1 9HA

31 July 2009

Dear Paul

<u>Preliminary Consultation on future regulation of Wholesale Mobile Voice Call Termination</u>

Virgin Media welcomes the opportunity to respond to Ofcom's preliminary consultation on the future regulation of wholesale mobile voice call termination. We set out below our views on the proposals made by Ofcom, together with our response to the specific questions posed.

We believe that this review of the future regulation of mobile voice call termination is a critical activity which will have material consequences for those affected by it including fixed and mobile operators. The wholesale regulatory framework that supports mobile voice call services needs to operate in a predictable, transparent and consistent way. Transparency and consistency are critical if network operators both fixed and mobile are to embark on the kind of long term infrastructure investment and technology/service evolution to which Ofcom aspires and which will ultimately deliver benefits in terms of innovation and price competition for consumers.

Virgin Media is somewhat concerned that Ofcom's desire to potentially move to a radically different methodology for mobile termination rates may be being inappropriately influenced by the outcome of the recent mobile termination litigation and a desire to avoid future litigation. However as Virgin Media makes clear later in its response in its view given the large sums at stake, litigation is likely to be present in the mobile termination market whatever the methodology adopted. In addition Virgin Media believes that Ofcom may also be inappropriately putting undue weight on the extent to which various options may reduce what Ofcom refers to as the regulatory burden.

Virgin Media suggests that many of the options suggested by Ofcom are merely likely to move the area of regulatory burden from one area of Ofcom to another and that the overall regulatory burden for stakeholders and for Ofcom is unlikely to be radically reduced.

Finally it is not clear that Ofcom has properly considered how a shift to a radically different methodology for one market alone will impact on other markets both in terms of regulatory principle and in terms of practical affect. Virgin Media suggests that a comprehensive assessment of how the adoption of new options would play out in terms of competitive dynamics and retail pricing would need to be undertaken before any option could be adopted.

As identified by Ofcom a key impact of many of Ofcom's proposals will be that mobile network operators will seek to recoup lost termination revenues from their customers in other ways.

[Redacted text]

Question 3.1 Do you agree with our preliminary view on market definition? Has anything changed for is anything likely to change within the period of the next market review which would materially impact on the definition of the market(s)?

Whilst Virgin Media broadly agrees with Ofcom's market definition it queries the fact that Ofcom will exclude self supply from the market. Virgin Media notes that the Commission's recommendation on markets merely provides for a market for voice call termination on individual mobile networks and is not restricted to supply to other CPs. Whilst Ofcom is obviously free to depart from the Commission's recommendation such a departure needs to be adequately reasoned and currently it is not clear that Ofcom has adequately established the need for on net calls to be defined in a separate market.

Whilst Virgin Media recognises that fixed to mobile substitution and convergence are likely to increase over the period of the market review, Virgin Media does not currently foresee that substitution and convergence are likely to occur to such an extent that a single retail and wholesale voice call termination market will be able to be defined within relevant timeframes.

Question 4.1 Do you agree with our view? Or are there other developments, not considered elsewhere in this consultation document, for potentially removing the underlying causes of SMP?

Virgin Media agrees with Ofcom's view that there does not appear to be developments occurring over the next price control period that would result in an absence of SMP for mobile operators.

Question 5.1 What are likely to be the main sources of detriment to consumers of excessive termination rates in the period 2011 to 2015?

Virgin Media agrees with Ofcom that the main sources of detriment to consumers arising from excessive termination rates in the period 2011 to 2015 are likely to be higher prices and the distortion of consumer choice.

Question 6.1 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 as 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?

Virgin Media queries the appropriateness of a change to MCT policy. It queries whether it is appropriate for Ofcom within the context of its statutory duties to pursue an approach of pursuing lower termination rates as far and as fast as it reasonably can and suggests that short term benefits to consumers from lower termination rates must be adequately balanced against the longer term benefits to consumers from continued investment and innovation. In addition in an effort to remove current distortions between fixed and mobile networks Ofcom should not move to the other extreme and risk new distortions arising. Rather Virgin Media believes that Ofcom should continue to adopt the measured approach of the LRIC+ regime that has served it well so far.

Question 6.2 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?

Virgin Media believes that the only other option would be to impose a simple cost orientation requirement on mobile operators. Such an option does not remove however the fundamental question of what constitutes cost and how that cost is to be calculated and is likely to lead to a series of disputes which Ofcom would be required to resolve in any case

Question 6.3 Do you agree with our preliminary views set out for reach of the options? If not, what are the additional factors that we should take into consideration and why are they relevant to our analysis?

Please see Virgin Media's comments for each of the individual options.

Question 6.4 Do you agree with our preliminary view of the de-regulatory option? If not what are the additional factors that we should take into consideration and why are they relevant to our analysis?

Given Ofcom's preliminary analysis of the mobile termination markets, Virgin Media suggests that it is unlikely that the mobile operators will not be found to have SMP in the relevant market. Under the current European framework, where the operators have SMP, Ofcom will be required to impose at least one regulatory obligation from the list of relevant obligations and therefore the deregulatory option will not be feasible. Even if this were not the case, Virgin Media would be very reluctant to see a situation where mobile operators were deregulated with respect to mobile termination whilst fixed operators remained regulated in relation to fixed termination. An environment where mobile operators were deregulated whilst fixed operators remained regulated would lead to distortions between fixed and mobile operators and is likely to place fixed operators at a severe competitive disadvantage

In addition Virgin Media suggests that Ofcom may be overestimating the administrative benefits that would flow from adopting a deregulatory option. Even in the absence of ex ante conditions, Ofcom would still retain its ability to resolve disputes under the Communications Act and to investigate matters within the framework of the Competition Act.

Given the past experience with unregulated 3G rates, Virgin Media predicts that in the absence of ex ante conditions dealing with mobile termination rates going forward, the reality will be an ongoing series of disputes between operators being referred to Ofcom for resolution. This is likely to be more administratively burdensome for stakeholders and for Ofcom than a single forward looking market review process. In addition, in contrast to a market review where conditions are set in advance and stakeholders are aware of the prices they are likely to be charged over a particular period, a deregulated market that was characterised by a series of disputes would be extremely uncertain and would negatively affect an operator's ability to accurately forward plan.

Question 6.5 Do you agree with our preliminary view of the LRIC+ option? If not what are the additional factors that we should take into consideration and why are they relevant to our analysis?

Virgin Media agrees with Ofcom's preliminary view of the LRIC+ option. Whilst it is clear that there are some questions about the application of various elements of the LRIC+ approach in the case of mobile termination, Virgin Media notes that the LRIC+ option has effectively served the UK regulatory regime well across a large number of markets and is well understood by all stakeholders. Virgin Media suggests that Ofcom should not be too eager to jettison an approach that works well across a number of markets within the UK merely because in the case of mobile termination, this approach has generated a litigious response.

Whilst litigation has been a factor in the mobile termination market, Virgin Media suggests that this reflects the importance of mobile termination revenues to the individual MNOs and to stakeholders such as BT as opposed to reflecting the paucity of the LRIC + methodology per se. Virgin Media suggests that for this reason it is highly likely that future litigation may be a factor in the mobile termination market, no matter what methodology is adopted as there will always be strong incentives for operators to challenge Ofcom's decisions.

Question 6.6 Do you agree with our preliminary view of the LRMC option? If not what the additional factors that we should take into consideration and why are they relevant to our analysis? In addition what do you expect the costs of a move to this option to be?

Virgin Media agrees with Ofcom's preliminary views on LRMC. Virgin Media suggests that if Ofcom were to adopt the LRMC approach or pure LRIC approach as the European Commission refers to it, then in line with the Commission's recommendation Ofcom will need to adopt a bottom up model. The development of such a model will have costs and will require intensive participation by stakeholders. As set out above there is no reason for thinking that the development and use of such a model will not also be the subject of litigation.

Virgin Media notes that it is not clear how great a reduction in termination rates will be brought about by the move to an LRMC model and suggests that in light of this it is not clear that the benefits of a move to an LRMC model will outweigh the costs of such a move.

Question 6.7 Do you agree with our preliminary view of the CBC option? If not what are the additional factors that we should take into consideration and why are they relevant to our analysis/ In addition what do you expect to the costs of a move to this option to be?

Virgin Media notes that the use of a capacity based charging model still requires the question to be answered of whether mobile operators should be allowed to recover common costs or not from mobile termination charges. Ofcom has not addressed in its consultation the question of whether common costs would or would not be recoverable in a capacity based charging model.

It is also not clear what the impacts of a move to capacity based charging model for mobile termination would have when fixed termination continued to be costed on a

LRIC+ basis and whether there might be unforeseen consequences from adopting such an approach.

In addition in the absence of any detail about how a move to a capacity based charging would be carried out and what systems and network changes operators might be required to invest in, Virgin Media suggests that this methodology should be rejected.

Question 6.8 Do you agree with our preliminary view on mandated reciprocity? If not what are the additional factors that we should take into consideration and why are they relevant to our analysis? In addition what do you expect the costs of a move to this option to be?

Virgin Media agrees with Ofcom's current suggestion that reciprocity is unlikely to be a suitable approach at the start of the next charge control period. Virgin Media strongly believes that network operators should be able to recoup their costs if investment and innovation are to continue.

Question 6.9 Do you agree with our preliminary view of the B&K option? If not what are the additional factors that we should take into consideration and why are they relevant to our analysis? In addition what do you expect the costs of a move to this option to be?

Virgin Media agrees with some of Ofcom's preliminary comments on B&K. It notes however that it is not clear whether Ofcom is proposing a B&K regime for intra mobile calls only or whether B&K would also be adopted for fixed to mobile calls. Given that Ofcom is currently consulting separately on the fixed termination regime it appears to Virgin Media that Ofcom is looking at a B&K regime for mobile operators only. If this is the case this immediately raises questions about the possibility of arbitrage and how such a regime will work in practice.

Virgin's key concern with a B&K regime is that by suggesting that there is no cost for mobile call termination this sends the wrong price signals and is likely to result in the inefficient consumption of resources.

It notes that before the Competition Commission in the recent mobile termination appeal Ofcom argued that an impact of combining a Net Payment Zero (NPZ) model (or effectively bill and keep) with a Calling Party Pays (CPP) regime would be that it would cause operators to act in economically inefficient ways. Ofcom also indicated that it would be unworkable to implement a NPZ approach for mobile operators alone.

Similarly many of the 2G/3G MNOs argued before the Competition Commission that an NPZ system failed to adequately account for the fact that mobile operators rely on pricing signals to manage the use of network capacity and that an NPZ system combined with a CPP system at retail level would prevent operators from managing network capacity effectively. The operators argued that an NPZ system combined with RPP would encourage operators to look for ways to shift traffic onto other operator's networks because they would not bear the cost of terminating such calls. This would include changing operator's incentives so that they either were incentivised to attract customers who made large numbers of outgoing calls but received few calls or to change the structure of their networks to take calls off net as quickly as possible.

In addition all of the 2G/3G MNOs argued that an NPZ system would result in MNOs recovering the costs of termination from other sources which in itself might have unintended consequences. MNOs argued that the choices they faced were imposing charges on customer to receive calls, setting prices for making calls or other services such as SMS so as to recover the costs of calls made, increasing upfront charges or reducing handset subsidies or some combination of each of these options. The MNOs argued that each of these options would lead to allocative inefficiencies.

Virgin Media believes that the points made before the Competition Commission are valid and would need to be worked through in order to adequately assess the relevant costs of the B&K option.

Virgin Media welcomes the opportunity to respond to this consultation and would of course be happy to discuss the matter further or expand on any of the points that we have made. Please do not hesitate to contact me should you wish to do so.

Yours sincerely,

Annemaree McDonough
Virgin Media