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**Response to Ofcom's Consultation of 1 April 2010 on
Wholesale Mobile Voice Termination**

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1. INTRODUCTION

XLN Telecom Limited – a Specialist Communications Provider Addressing the SME Market

- 1.1. XLN was founded in 2002 to provide telecommunications services (including lines, call, broadband, mobile and other related services) exclusively to the UK small business market of some 4m enterprises. XLN prides itself in providing these telecommunications services at a low cost to its small business customers whilst maintaining excellent levels of customer service.
- 1.2. XLN finds that its small business customers are cost conscious and demand great service. In order to meet the requirements of small businesses, XLN needs to ensure that they are able to accurately cost their products and generate and maintain competitive tariffs. To this end, XLN negotiates rates with its call providers in order to maximise savings that can then be passed on to customers. Achieving fixed rates from suppliers allows XLN to pass on fixed rates to the customers giving them certainty over their call spend budgeting and enabling the customers to allocate more resource to driving business growth.
- 1.3. XLN welcomes the opportunity to respond to the Consultation, and given its experience as a telecoms supplier to the SME market, believes that its views will be helpful and important for Ofcom to take into consideration.

2. Executive Summary

- 2.1. XLN is pleased to lend its support to Ofcom's proposals to reduce MTRs to pure LRIC. XLN welcomes Ofcom's policy over the years in having reduced MTRs, which has brought about benefits to UK consumers and businesses who have benefited from the existence of alternative operators providing competitively priced services together with dedicated customer services.
- 2.2. In particular, XLN supports Ofcom's proposals to:
 - 2.2.1. adopt the EC Recommendation and thereby requiring LRIC based MTRs;
 - 2.2.2. to apply MTRs to other mobile call providers on a fair and reasonable basis; and
 - 2.2.3. address the issues of time of day charging and flip-flopping.
- 2.3. XLN is directly affected by the impact of MCPs appearing to exploit the loopholes in the current regulations. For example, despite existing MTR caps indicating that MTRs should be reducing, XLN has seen its average mobile pence per minute cost base increase by more than 25% since October 2009.
- 2.4. XLN does not believe that there is any objective justification for such increases nor for some of the differences in time of day rates imposed by some MCPs or the significant variations from month to month as part of the flip-flopping tactics used by some MCPs.
- 2.5. Therefore, XLN considers that the first three of Ofcom's proposals for addressing the flip-flopping issue are insufficient and instead Ofcom should adopt its Option 4 to properly address the issue.
- 2.6. XLN considers that competing communication providers ("CPs") would significantly benefit from Option 4, in that the additional certainty would allow operators to accurately predict the MCTs which should in turn lead to efficiencies for these operators that will be passed on to consumers and SMEs. Option 4 has the additional advantage of being clear and easy to monitor compliance.

3. Comments on market definition and SMP assessment

- 3.1. Elsewhere, XLN supports the Ofcom approach in defining 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 (**question 3.1**).
- 3.2. XLN agrees with Ofcom's proposals to regulate calls to given UK mobile number ranges as set out in Ofcom's table at paragraph 3.62 of the Consultation on the specific call types that should be included in the market. XLN agrees that it is the control over switching and routing of calls to specific number ranges that is unique and cannot be replicated by any other provider. CPs such as XLN require certainty as to the rates it will be charged in routing calls to a particular number range, regardless of whether the termination is via VoIP, 2G or 3G or whether it is a call to voicemail for example. (**question 3.3**).
- 3.3. XLN concurs with the Ofcom position of designating 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 number range. XLN also agrees with the proposed SMP assessment for the period until 2014/15 (**question 4.4**).
- 3.4. XLN warmly supports the Ofcom intention of regulating directly the termination charges of the four MCPs which operate fully-deployed national mobile networks (referred to in this Submission as "MNOs"). XLN would support the same rate being set for all four networks after the transition period.

4. Comments on Remedies for addressing Consumer Harm

- 4.1. XLN strongly supports the Ofcom position that lower MTRs and pure LRIC will be more reflective of network cost structures. Accordingly XLN supports the proposal to adopt a pure LRIC approach.
- 4.2. XLN agrees with the identified harm to consumers of excessive termination rates in the period 2011 to 2015 (**question 5.1**)

5. Responses to Selected Questions

Consultation Section 7

Question 7.1 – *do stakeholders agree with Ofcom’s view regarding the need for transparency in MCT charges?*

- 5.1. XLN of course supports the Ofcom position regarding the need for transparency in MCT charges

Question 7.2 – *Do stakeholders agree with our preliminary view on application of a condition requiring network access to be provided on F&R terms?*

- 5.2. XLN agrees fully with a requirement that other MCPs to provide call termination on fair and reasonable terms.

Question 7.3 – *what are your views on the need for an ex ante undue-discrimination condition for the period of the next review?*

- 5.3. XLN agrees with the need for an ex ante undue-discrimination condition for the period of the next review.

Question 7.4 - *Do stakeholders believe that there are any circumstances or situations where the UK differs from other EU markets to the extent that would support a departure from following the EC Recommendation?*

- 5.4. Adopting pure LRIC would be in the commercial interests of service providers of MCPs, but the overall effect on the sector would also be hugely beneficial. XLN commends pure LRIC as providing the basis of efficiency gains for MCPs generally, and also the basis of minimizing the on/off net differential between fixed and mobile. There is no apparent justification for Ofcom to adopt any position other than that recommended by the European Commission.

Question 7.5 – *do you agree with Ofcom’s proposals for its preferred set of remedies for the provision of MCT services?*

- 5.5. XLN agrees with the stated proposals for its preferred set of remedies for the provision of MCT services.

6. Consultation Section 9

Question 9.1 – *Do you agree that a four-year period for the SMP remedies is appropriate?*

- 6.1. XLN agrees also with the proposal of using 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 the charge control period. The four year glide path will provide a predictable MTR regime for service providers to build their business plans.

Question 9.2: *Do you agree with our proposed modelling approach, as discussed in this section, the supporting annexes and the actual model? If not, please discuss the specific proposals you disagree with.*

6.2. XLN has no comments on the precise modelling approach taken.

FLIP-FLOPPING and TIME OF DAY VARIATIONS

Question 9.3: *What is your view of the harm caused by flip-flopping?*

7. Background

- 7.1. Ofcom rightly refers in paragraph 9.110 to concerns over frequent and significant variations in MTRs by some MCPs (flip-flopping). XLN entirely agrees that the MCPs appear that have been exploiting a facet in the charge control to secure extra revenue in ways that neither Ofcom nor fixed line providers had anticipated.

8. Evidence of Flip Flopping and of Time of Day Variations

- 8.1. The clearest example of flip-flopping is that, despite existing MTR charge control regulations, XLN has seen its average mobile pence per minute cost base increase by more than 25% since October 2009ⁱ.
- 8.2. Table 1 of the Confidential Schedule submitted sets out how the average rates invoiced to XLN have increased since October 2009 by the 25% mentioned above. The average rate has been calculated by dividing the total invoice per MNO by the total minutes sent for termination to that MNO during the month in question.
- 8.3. These average rates being charged to XLN albeit via BT Wholesale are significantly above the current Target Charge.
- 8.4. Table 2 of the Confidential Schedule submitted sets out the peak rates that XLN has been invoiced by BT Wholesale for mobile termination over recent months. As with the average rates, the peak rates (which are the most important rates for CPs addressing UK businesses) are substantially above the current MTR Target Charge.

9. Impact on XLN and other service providers

- 9.1. The UK has a dynamic telephony sector with a number of service providers, some of whom target specific niches. Many segments of the market are highly competitive. In such an environment, cost control and cash flow management become increasingly important to the survival and success of the businesses. Variations in MTRs can therefore have a significant impact on the viability of these businesses.
- 9.2. Service providers that target specific niches can have calling patterns that are significantly different to the overall averages. As such, these operators could be disproportionately affected by unjustified differences between the daytime, evening and weekend rates or by flip-flopping.

ⁱ To be more specific, BT Wholesale invoices XLN for the mobile termination rates BT has to pay the MNOs, passing these rates on to XLN plus a certain margin.

- 9.3. XLN target customers are SMEs and therefore it has and can be expected to continue to have relatively more calls to terminate during the day than an operator with a broader customer base.
- 9.4. It appears that XLN (and presumably other competing telecoms operators serving business customers) have been disproportionately discriminated against by the time of day MTR variations and flip flopping.
- 9.5. The MNOs themselves are increasingly targeting SMEs with mobile only or fixed mobile solutions. An unjustifiably high termination rate during the day would provide an unfair advantage to the MNOs in competing with XLN and other providers that target business customers.

10. Profitability

- 10.1. Termination rates and, in particular, MTRs therefore have a significant effect on the cost of XLN providing its service and therefore on its profitability and ability to invest in dedicated customer support services.
- 10.2. XLN estimates that a penny per minute increase in its average MTRs results in an additional annual cost of £335,000 to 400,000 per penny increase per annum. Such level of additional cost has a significant impact on the profitability of XLN.
- 10.3. XLN is committed to honouring the fixed mobile rates offered to its business customers so cannot adjust its prices to take account of these variations. Even were XLN contractually authorised to change its mobile termination rates on 30 days notice, the competitiveness and price sensitivity of the retail market means that it is commercially impossible for XLN to pass on any additional fluctuating monthly costs to customers.
- 10.4. XLN's experience of the needs of SMEs is that they require a fixed price for calls to any mobile network and need to be able to budget each financial year for the anticipated costs of calls to mobile networks, which for most of XLN's SME customers is the single largest and most important element of their call charges.

11. Financial Planning

- 11.1. Whilst it is clear that the average MTR has an impact on XLN, it should also be noted that the unpredictable and sometimes large variations in MTRs also has a negative impact on operators such as XLN.
- 11.2. The other negative impact on XLN from flip flopping is that it reduces XLN's ability to accurately model / forecast future costs and therefore reduces its ability to accurately forecast future cash flows and profitability. Such forecast / modelling are key to the operators' investment decisions and ability to raise financing to fund growth. The predictability of MTRs is therefore also important to CPs such as XLN.

Question 9.4: *Do you agree with our preferred option for resolving the issue of flip-flopping*

12. Introductory Comments

- 12.1. As already stated above, XLN agrees with OFCOM's proposals that MTRs should be:
 - 12.1.1. fair and reasonable;
 - 12.1.2. without undue discrimination; and
 - 12.1.3. progressively reduced in a predictable manner to an operator neutral, technological neutral, efficient operator LRIC based charge.
- 12.2. In XLN's opinion these principles should apply not only to the yearly average MTR but also consistently throughout the year to any particular MTR.
- 12.3. XLN considers that any difference in the MTRs between evening, daytime and weekend should be justified on the basis of different LRIC based costs for terminating at different times or with another objective justification. Having reviewed OFCOM and Analysys Mason's assessments, it seems unlikely that there is a justification for there being a significant difference (or indeed any difference) between the time of day MTRs.
- 12.4. In XLN's view it seems unlikely that any variations would be designed to promote efficiency and, given this, it might be appropriate that the MCPs should be required to positively justify any variations in MTRs.
- 12.5. In 9.114 Ofcom states "*Our general approach to setting charge controls is to intervene no more than is necessary to achieve our regulatory aims. And allowing MCPs a degree of pricing freedom can allow them to vary the structure of charges, which can help promote efficiency.*"
- 12.6. XLN does not disagree with either statement. XLN also notes the potential theoretical rationale for allowing price flexibility as set out in paragraph 9.114.
- 12.7. However, it seems clear that that this flexibility has not been used to promote efficiency and has to a degree undermined the effectiveness of Ofcom's charge control regulation. In other words, the flexibility has been taken advantage of by certain MCPs to gain extra revenue beyond those set out in the Ofcom caps. It has also had the effect, deliberately or otherwise, to unfairly disadvantage certain operators.
- 12.8. Ofcom should also take into account the impact of allowing MCPs such flexibility on the other telecoms service providers.
- 12.9. Therefore, it seems clear that extra regulation in relation to flip-flopping is required to ensure that the regulatory objectives are obtained.

13. Option 1

- 13.1. XLN notes the potential theoretical rationale for allowing price flexibility as set out in paragraph 9.114. However, this flexibility has been taken advantage of by certain MCPs to gain extra revenue beyond those set out in the Ofcom caps.
- 13.2. Option 1 continues the status quo which would allow for the issues that Ofcom has highlighted in its consultation and the issues XLN has explained above to continue. Indeed, it can be expected that that such tactics might be used with increasing effect should Ofcom continue with this approach (since it would be seen as tacit approval by Ofcom if Ofcom identifies the issue and does not address it).
- 13.3. The flip-flopping is clearly not objectively justified and does not appear to promote efficiency.
- 13.4. Under Option 1, certain CPs such as XLN would continue to face unjustifiably high average MTRs and pricing uncertainty (as explained at above. This is simply not acceptable.

14. Option 2

- 14.1. Option 2 has a number of advantages over Option 1 in that it limits the frequency of changes and any average potential increase within a year to 20%.
- 14.2. XLN agrees with Ofcom's hypothesis that:
 - 14.2.1. changes should not be needed more often than once per quarter; and
 - 14.2.2. a 20% limit on the increase should be sufficient.
- 14.3. However, XLN has a number of concerns with the proposal:
 - 14.3.1. the proposal does not address any unfair time of day differences imposed by MCPs;
 - 14.3.2. CPs could still face unduly high average MTRs depending on the calling patterns of their customers;
 - 14.3.3. within the 20% overall increase, there appears to be significant scope for a particular rate to vary (in other words, the daytime rate could increase by 40% and the other rates be reduced) resulting in an unnecessarily high degree of uncertainty as to MTRs;
 - 14.3.4. the system seems overly complex given that little if any variation between time of day or in course of year is likely to be justifiable; and
 - 14.3.5. compliance might be unnecessarily complicated to monitor.
- 14.4. Whilst we note that Ofcom estimates that this proposal would reduce the overall benefits to MNOs by 90%, it does not necessarily mean that the harm suffered by CPs would be reduced by 90%. This is because individual CPs might still end up paying average MTRs significantly

higher than the average MTRs set by Ofcom and CPs would still need to deal with the uncertainty of future MTRs.

15. Option 3

- 15.1. XLN supports the thinking that the differences between day, evening and weekend rates needs to be regulated. However, XLN considers that any such differences should be justified on a cost basis.
- 15.2. XLN's view (which appears to have some support from Ofcom's analysis) is that there is unlikely to be any cost based justification for a significant variation of MTRs between daytime, evening and weekends.
- 15.3. While Option 3 would prevent some of the manipulation that has occurred in the past, XLN does not consider that the fixed ratio addresses the underlying problem.

16. Option 4 (The Option XLN Considers Most Suitable)

- 16.1. XLN notes Ofcom's concern that this Option would remove the ability of MNOs to differentiate by time of day to incentivise efficient network use. However, Ofcom further notes that it appears that current use of time of day flexibility is not currently used to incentivise efficient network use.
- 16.2. Therefore, it is not clear to XLN why Ofcom has not proposed this Option 4, in particular given its many advantages over the other Options.
- 16.3. In XLN's view, Option 4 has the following advantages:
 - 16.3.1. certainty and simplicity;
 - 16.3.2. minimal compliance and monitoring costs;
 - 16.3.3. CPs have clarity on future MTRs when setting retail prices and making investment decision; and
 - 16.3.4. there would be no scope for undue distortion between time of day charges and no flip flopping.
- 16.4. In the same way that a set four year glide path provides the MNOs the opportunity to plan an invest on the basis of predictable MTRs, adopting Option 4 would likewise provide the same environment for all CPs to plan four years ahead and efficiently invest in developing new services and price competitive services in the market. XLN assumes that the benefits of these efficiency gains will be passed on to consumer and business customers.
- 16.5. XLN considers that simplicity, stability, and certainty of Option 4 would lead to economic efficiency gains that would far outweigh the potential network efficiency gain from MNOs being able to vary prices by time of day. XLN would be surprised if there was much evidence to show that the flip flopping had a material impact on the efficient network utilisation.

17. Conclusion on Time of Day Charging and Flip-Flopping

- 17.1. XLN supports Ofcom's proposal to address the issue of flip-flopping. XLN endorses the Ofcom view that this practice forces CPs to incur extra costs, as the MTRs are frequently changed by significant amounts but XLN considers that the proposed Option 2 is not sufficient to fully address the harmful effects of flip-flopping.
- 17.2. XLN is convinced that there is no justification for the current differences between daytime, evening and weekend rates, even more so given how the differences have been taken advantage of by the MNOs in flip-flopping
- 17.3. XLN supports Option 4 as the best way forward. The advantages are clear whilst XLN considers that the potential disadvantage is only a theoretical one. Advantages are certainty and simplicity whilst compliance costs would be the lowest, enabling all operators to more accurately budget for investment.
- 17.4. XLN does not consider that Option 4 would impact on the efficient utilisation of networks nor that the current flip-flopping practices were designed to improve the efficient use of networks.
- 17.5. XLN is therefore convinced that Option 4 provides for the best solution to address the flip-flopping and time of day charging issues.

Question 9.5: *Are there other, more proportionate solutions that we should consider?*

- 17.6. In the unlikely event that the MNOs can demonstrate that imposing a constant MTR regardless of time of day would lead to network inefficiencies, then XLN would support a hybrid Option whereby Ofcom set a constant MTR for daytime, evenings and weekends.



Schedule 1: Confidential Submissions & Tables

(Separate attachment)