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15 May 2015

Dear David,

Non-confidential response to Ofcom's review of fixed call origination and termination markets 2016-19: Call for inputs – Confidential redactions marked with [✂].

I write to you in relation to Ofcom's call for inputs ("CFI") on the review of fixed call origination and termination markets for the period 2016-19 ("FCOT review"). EE Limited ("EE") welcomes the opportunity to comment on Ofcom's proposed scope of the FCOT review.

EE agrees with the broad scope of the FCOT review. We expect to have more comments once the FCOT review progresses to the full consultation phase. In this response to the CFI we have limited our response to a few key issues that we believe it is important for Ofcom to address within the scope of the review. In summary we consider that:

- There are compelling reasons to include wholesale fixed call termination to the 03 number ranges within the scope of Ofcom's FCOT review. This includes the need to ensure that changes in geographic termination rates are reflected in 03 termination rates.
- Ofcom should assess whether applying a charge control to all communication providers ("CPs") that are deemed to have significant market power ("SMP") in the provision of fixed termination would be more appropriate, given the increasing number of CPs that are not complying with the fair and reasonable terms imposed by Ofcom in its 26 September 2013 statement reviewing the fixed narrowband services markets (the "2013 Narrowband Statement").
- Ofcom should review whether regulated charges should continue to be set on a "time of day" basis (i.e. evening and weekend rates). EE notes that a single maximum cap has been adopted in a number of other wholesale market reviews

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including the mobile call termination review ("MCT review"). This price cap structure creates benefits by introducing greater clarity and transparency in the charges set by CPs, thereby facilitating more efficient pricing of fixed voice calls.

We discuss these points in more detail below.

03 termination rates

In the 2013 Narrowband Statement, Ofcom defined the regulated fixed wholesale call origination markets to include fixed origination to both geographic and non-geographic numbers, but has excluded termination of calls to non-geographic numbers from the wholesale fixed termination markets it has defined. This was in spite of Ofcom's finding that "*As with geographic calls, once the originating CP's subscriber has chosen to call a particular non-geographic number, the originating CP has no alternative to purchasing wholesale call termination from the TCP hosting that non-geographic number*" (§6.42). Ofcom's stated rationale was that it did not consider that it was an appropriate time to undertake a review of non-geographic call termination as a part of its 2013 narrowband market review, due to the significant changes to the way the non-geographic market operates, which were expected to come into effect in Summer 2015 as a part of Ofcom's non-geographic call services ("NGCS") reforms (§6.47). However, the charges for calls to 03 numbers will not be affected by Ofcom's NGCS Reforms, and are in that sense unique and distinct from the other non-geographic ranges which will be subject to the new "unbundled tariff structure".

In the 2013 Narrowband Statement, Ofcom also distinguished the termination of non-geographic calls from the termination of geographic calls due to Ofcom's view that terminating CPs ("TCPs") would be influenced by the preferences of their service provider ("SP") customers when setting termination rates to non-geographic numbers (§6.45). However, the potential for 03 SPs to influence the 03 termination rates charged by TCPs to originating CPs ("OCPs") is strictly limited by the unique regulatory restrictions applicable to the range:

- In relation to other non-geographic ranges, Ofcom has noted in the 2013 Narrowband Statement that SPs are sensitive to the termination rate that TCPs charge, because the TCP is likely to pass some of the termination revenue to the SP (either directly, through a revenue-sharing arrangement, or indirectly by way of reduced or waived charges for hosting services that the SP would otherwise pay). In the case of 03 numbers, it is not possible for TCPs to share any of their termination revenue with the SP, as this would involve a violation of the restriction on revenue-sharing in the National Telephone Numbering Plan. In its February 2007 statement on the 03 number range, Ofcom clarified its policy intention that "*Ofcom would expect that the*

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costs of providing value-added services to SPs would be met by those SPs" (§3.37). More recently, the BIS guidance that the 03 range complies with the "basic rate" requirements of the CRD has been issued on the basis that such 03 numbers do "*not provide the trader with a contribution to their costs*".

- In relation to other non-geographic ranges, OCPs also have greater retail pricing flexibility than they have in relation to the 03 range:
  - For example, it is possible for OCPs to exclude other individual non-geographic number ranges from their inclusive retail offers of "bundles" of minutes – such as where the range is found to be used for the provision of call-forwarding services, or to be generating what are considered to be artificially high levels of traffic ("AIT").
  - Theoretically at least, this means that high termination rates charged for calls to a specific non-03 number range block on which an SP provides services, may cause an OCP to charge higher retail prices for calls to that specific non-03 number range block. This may lead to a reduction in calls to that number range block, which might in turn cause the SP to try to influence the TCP to reduce its termination charges.
  - However, with the 03 range, this is not even a theoretical possibility. This is because OCPs are required to charge all 03 calls at the same rate as they charge calls to 01 and 02 numbers, which means that they cannot directly reflect the termination rate for an individual 03 number range block in their retail pricing. This OCP retail pricing inflexibility removes any prospect that an SP would seek to influence TCP termination rates in order to influence OCP retail pricing for their range. Of course, high 03 termination rates are likely to drive up overall 01, 02 and 03 OCP retail prices for calls to these ranges – however because of the range of numbers involved, an individual 03 SP is unlikely to be able to change this outcome in

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any material way even if it was successful in influencing its TCP to reduce the termination rate for its particular 03 number block.[1] Indeed, the notion that different 03 termination rates might drive differential OCP pricing behaviour, seems to be somewhat of an anathema to the perceived benefits of the 03 range for SPs, with Ofcom noting in its February 2007 statement that:

> "*Many organisations (including not-for-profit bodies whose functions are often closely associated with equity issues) would therefore be deterred from migration by the prospect of different OCPs taking different approaches to whether their 03 prices should match 01 and 02 prices. Whilst SPs could, in theory, enable the public to call them on different types of numbers (e.g. 03 or 0800) according to the OCP involved, this is a significantly worse option and a formidable marketing challenge*" (§3.28)

In the 2013 Narrowband Review Statement, Ofcom also considered that non-geographic numbers were different to geographic numbers, because "*SPs can and do switch between TCP hosts on the basis of their competitive offerings, including their termination rates*". Again, this does not seem to hold true for the 03 number range. A review of BT's Carrier Price List indicates that all other TCPs currently charge exactly the same rate for the termination of 03 calls. In Ofcom's 2013 final Statement on the NGCS reforms, Ofcom has noted that its 2011 03 Dispute Determination between EE and BT, has acted as an "industry standard", which has been "adopted throughout industry" (§4.105). It seems therefore, that any switching between 03 TCP hosts by SPs that has taken place since this determination, has <u>not</u> been on the basis of the termination rates offered by those TCP hosts.

If it were true that there really was some competition between 03 TCPs, in relation to the termination rates charged to OCPs driven by the ability of SPs to switch hosts, one might have expected to see at

[1] Naturally, the same difficulty confronts an OCP in attempting to directly constrain a TCP from increasing its 03 termination rates by increasing its retail pricing – because the TCPs specific 03 ranges cannot be singled out from other 03 ranges and from the OCPs charges for 01 and 02 calls, it is simply impossible to do this effectively.

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least some variation in these 03 termination rates – particularly in the lead up to the increasing popularity of the 03 range to corporate and government SPs, as a result of the Consumer Rights Directive "basic rate" requirements – yet, so far as EE is aware, there remains none. This result is entirely consistent with Ofcom's vision for the 03 range – as simply a non-geographic extension of the geographic 01 and 02 ranges (on which Ofcom has consistently found each TCP to have SMP):

> *"Moreover, the impact of opening the 03 range and enabling SPs to migrate to 03 numbers would be the same as if SPs were just choosing to move back to 01 or 02 numbers. Ofcom, by creating 03, is giving SPs a further migration option to react to their customer's needs and wishes without forcing them to lose the marketing and operational benefits offered by non-geographic numbers"* (February 2007 Statement, §3.36)

Subject to applicable regulatory constraints, in the event of any attempt by an 03 TCP to set prices for its termination services appreciably above the competitive level, fixed and mobile OCPs have the ability – as is the case with termination to 01 and 02 numbers – to decline to buy these services i.e. to refuse to originate calls to the relevant number ranges/blocks of the TCP. For this to be an effective constraint on the TCP's market power, the OCP must be able to exert sufficient countervailing buyer power ("CBP") such that the TCP is unable to act independently of its competitors, customers and consumers. In the 2013 Narrowband Statement, Ofcom found that no OCP was likely to have sufficient CBP to constrain BT's SMP in the supply of termination services to 01 and 02 numbers "*as they require BT's termination service in order to offer a credible service to their customers*" (§§6.72-§6.74). In particular, given the increased importance of the 03 range (since the requirement for organisations to offer "basic rate" helplines and associated government and industry initiatives promoting use of the 03 range), EE considers that OCPs suffer the same inability to constrain BT pricing for the termination of 03 calls through their CBP. **[✂].**

EE believes that there are compelling reasons to include the 03 number range within the scope of this FOCT review. In particular, EE considers that the inclusion of 03 number ranges within the FOCT review could help address concerns raised by both Ofcom and other stakeholders around the inconsistency between 03 termination rates and BT's fixed geographic termination rates ("FTRs").

In the 2013 Narrowband Statement Ofcom adopted the pure long run incremental ("LRIC") cost standard to set the charge control for BT's FTRs. This represented a significant reduction in regulated geographic termination rates (Ofcom estimates a reduction of around 85% at the time). Ofcom has, subsequent to this review, concluded in its 2015 Final Determination on the Dispute between BT and each of EE and Three regarding BT's charges for terminating calls to 03 numbers, that

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"*In order to maintain consistency with the approach we [Ofcom] adopted in those previous disputes, we believe that BT would need to have reflected the change in its geographic termination rates to LRIC in its 03 termination rates*" (§4.13). Despite this, Ofcom goes on to note that "*BT has not adjusted its 03 termination rate to reflect the change in our [Ofcom's] approach to the regulation of fixed geographic call termination*" (§4.11). Within the Final Determination on the dispute, Ofcom also noted its concerns that current 03 termination rates across the wider industry may encourage arbitrage activity (§4.123).

EE considers that the FCOT review represents an important opportunity for Ofcom to address these concerns, and in particular the inconsistency between current 03 termination rates and the aim of Ofcom's previous determination on 03 termination rates, which focused on supporting the alignment of retail prices of 03 calls with 01 and 02 calls. We consider that the change in approach from the 2013 Narrowband Statement is justified by the vastly increased, and increasing, importance of the 03 range compared to the position in 2013, as well as the matters we detail above. In the 2013 Narrowband Statement, Ofcom stated that it would consider whether any further review of the market for call termination to non-geographic numbers was necessary once its NGCS review had been completed and any resulting proposals implemented (§6.47). EE notes that, following the NGCS reforms, which now regulates prices for all other non-geographic number ranges (i.e. 0845, 0870, 080 etc.), 03 number range remains the only non-geographic number range that is not regulated in some form or other.

Fixed termination charge control for all CPs

In the 2013 Narrowband Statement for fixed wholesale call termination, Ofcom concluded that each CP held SMP in respect of wholesale call termination to its number range. Despite this Ofcom decided to impose charge controls on BT but not on other CPs. Instead, CPs other than BT were subject to a fair and reasonable terms, conditions and charges requirement. Ofcom justified this on the basis that setting a charge control on other CPs would be costly and disproportionate.

Since this review, EE has observed an increasing trend of smaller CPs not complying with the fair and reasonable terms set by Ofcom. Ofcom has addressed a similar concern in the context of the MCT review, by imposing a charge control on all CPs. EE considers that in light of this, if Ofcom concludes that a charge control is an appropriate remedy fixed wholesale termination services, it should be imposed on all CPs found to have SMP in the provision of these services.

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"Time of day" termination rates

In the CFI, Ofcom has stated its intention to review whether flexibility to allow CPs to set different termination rates by "time of day" is still required for the efficient pricing of fixed voice calls (§3.10.2). EE notes that a single maximum cap has been adopted in the context of the MCT review. We also consider that "time of day" rates create confusion around pricing and make it more difficult to assess whether a CP is complying with the relevant remedy (e.g. the charge control or fair and reasonable terms). In contrast, a single maximum cap has the advantage of providing greater clarity and transparency around whether a CP is complying with the relevant remedy. On this basis we agree that Ofcom should review this area and consider adopting a single maximum cap in the interests of regulatory consistency and facilitating efficient pricing of fixed voice calls.

If you or the team have any queries about this response please contact Matthew McDermott at matthew.mcdermott@ee.co.uk or 07947876565.

Yours Sincerely,

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