**BASIC DETAILS**

**Consultation title: Mobile call termination market review 2018-21**

To (Ofcom contact): Lucy Reid

Name of respondent: [Confidential]

Representing (self or organisation/s): Telefonica UK Ltd

Address (if not received by email):

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## Executive summary

**Telefónica UK Limited**
260 Bath Road
Slough
Berkshire
SL1 4DX
T +44 (0)113 272 2000
www.telefonica.com

Telefonica UK Ltd ("O2") welcomes the opportunity to respond to Ofcom's consultation document on mobile call termination.

We do not believe that Ofcom has come to the right result in the consultation as it appears that the proposed charge control is set too low, and -in the absence of any glide paths- it drops too fast and as a result, there is a real risk of consumer harm. Indeed, Ofcom's focus is again on LRIC rather than LRIC+, although the choice between two cost standards appears at best marginal. The key test should be the overall impact on consumers, balancing short term impacts with longer term dynamic effects on investment. Contrary to Ofcom's proposed approach, O2's position is that consumers' interests would be best served if MTRs were set at a level in excess of LRIC (compared to setting them at LRIC). That is because we do not believe that the competition benefits of further reductions in MTRs would be significant while it could risk endangering MNO's investment incentives.

Regarding the scope of the proposed charge control, while O2 welcomes Ofcom's proposals to extend any charge control remedy to smaller MCPs, we believe that adopting a single uniform benchmark is unjustified given that many smaller, "asset-light", MCPs face significantly lower costs than the four MNOs.

Further, O2 considers that making an immediate one-off adjustment to the maximum MTR benchmark would constitute a serious error of judgement. It would undermine regulatory certainty, being clearly contrary to Ofcom's well established approach and often stated policy preference for glide paths.

In the remainder of this response, we provide answers to selected questions set out in the consultation document.

## Answers to selected questions

**Question 3.1: Do you agree with our view of the relevant market and assessment of significant market power? If not, please explain why.**

For the purposes of its market definition analysis and market power assessment, O2 believes that Ofcom has failed to recognise the importance of the evolving competitive constraint posed by OTT voice services[1]. In the period 2012-2014, the use of OTT voice services became significant. This trend has been supported by increasing levels of penetration of smartphones, as well as improved mobile data services including through the launch of 4G (and will strengthen further with the deployment of 5G technologies which will provide very high speed data access and is expected to be used for enhanced mobile broadband, communications between machines and ultra-reliable and low latency communications). This rapid acceleration in OTT usage is reflected in WhatsApp's launch of an OTT voice service in 2014 across its global platform that currently accounts for 50 million monthly active users.

In order to justify its decision to excluded OTT voice services from the market definition, Ofcom quotes the European Commission ("EC") Recommendation on Relevant Markets issued on 9 October 2014, in which the EC states that '*currently OTT services are not yet at a level in which they can be considered actual substitutes to the services provided by infrastructure operators*'. That recommendation is now three years' old. In a sector

[1]Ofcom consultation on mobile call termination market review 2018-21 at paragraph 3.27.

like the UK mobile market, where technological developments occur very frequently, relying on a recommendation dating back to 2014 does not seem to be appropriate.

Further in the Recommendation, the EC acknowledges that '*services which although today* [2014] *may not be considered as direct substitutes to services provided by electronic communication service providers, technological developments are likely to result in their a continuous expansion in the coming years'*[2]. Thus, in O2's opinion, this is likely to reveal that, OTT services will potentially (if not yet) become a sufficient constraint to traditional mobile voice services over the duration of the next charge control period (2018-2021). Hence, we believe that Ofcom should consider the OTT voice services within the relevant market, especially given the forward looking perspective of the assessment which it is required to conduct.

**Question 4.4: Do you agree that our proposal to impose a charge control on all MCT providers with SMP is appropriate? If not, please explain why.**

O2 agrees with the proposal to impose a charge control on all MCPs found to hold SMP.

However, while O2 welcomes Ofcom's proposals to extend any charge control remedy to smaller MCPs, we believe that adopting a single uniform benchmark is unjustified given that many smaller MCPs face significantly lower costs than the four MNOs. Indeed, we are concerned that a single uniform charge control approach would limit Ofcom's ability to enforce charges below the benchmark rate where MCPs, such as asset-light MCPs, have efficiently incurred costs lower than this level.

Ofcom justifies its approach by saying that [a]*ny economic inefficiency resulting from asset-light MCT providers being allowed to charge above their efficiently incurred costs but under the cap would likely be of very limited scale particularly given the low level of the current and (proposed) MTR*[3]. In addition, Ofcom states that, *in some cases, it may also be difficult for us* [Ofcom] *to determine if a given MCT provider should be treated as an asset-light MCT*[4].

In O2's opinion, these are not strong enough arguments to justify the imposition of asymmetrical conditions which, in practice, could give a competitive advantage to those operators who are able to charge above their LRIC. In fact, experience suggests that this would be likely to be exploited by some providers. For example, providers might fund international call forwarding services or some other revenue sharing arrangement from revenues that exceed costs. As a result, originating communication providers may well react by excluding calls to such services from retail call bundles, and this would harm consumers' interests.

O2 further considers that, if Ofcom were to apply a uniform maximum MTR to smaller mobile communications providers despite the significant variances in their underlying costs, this would risk contravening Ofcom's statutory duty to ensure that any SMP conditions are "not such as to discriminate unduly against any particular persons or against a particular description of persons"[5] Hence, applying a uniform maximum MTR would be clearly discriminatory and would distort investment incentives. O2

[2] European Commission Recommendation of 9 October 2014 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services.
http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014H0710&from=EN

[3] Ofcom consultation on mobile call termination market review 2018-21 at paragraph 4.58.

[4] Ibid 5.

[5] Section 47(2) of the Act.

therefore considers that smaller MCPs should be regulated at a lower rate, unless they can demonstrate to Ofcom that their costs justify the rate applicable to the four MNOs.

**Question 4.5: Do you agree with our proposal that LRIC should continue to be the appropriate cost standard? If not, please explain why.**

No.

Since 2010 there has been extensive debate in the UK on the appropriate cost standard to apply in wholesale voice termination regulation. In 2012, the Competition Commission decided to support Ofcom's conclusion that, based on the circumstances in 2012, the LRIC cost standard should be applied to mobile wholesale voice regulation. However, O2 believes that this decision issued by the Competition Commission in 2012 does not preclude the need to re-consider, in this new market review, the choice of cost standard in the light of different evolving factors which affects the next charge control. Even more so, considering that Ofcom has failed to present any reliable evidence that moving from LRIC+ to pure LRIC has provided any material benefits for consumers.

O2 argues that Ofcom has incorrectly considered that its options are limited to a binary choice between LRIC and LRIC+, without even evaluating other levels within the potential range of efficient cost standard. Furthermore, LRIC is the very lowest of the potential range of efficient charges. Its adoption would result in an asymmetry of risk in relation to setting a rate that is below an appropriate level through the charge control.

Indeed, in our view, it is inevitable that consumer welfare would be increased if charge controls were set above the current LRIC level as this will incentivise investment by the MNOs.

**Question 4.6: Do you agree with our proposal to apply the charge control to all calls, including those originated outside the EEA? If not, please explain why.**

Ofcom states that UK MTRs are currently capped at LRIC regardless of where or from what type of network the call originates. However, Ofcom acknowledges that, within the EEA, national regulatory authorities have adopted different approaches to regulation of calls from outside the EEA[6]. In fact, these different approaches do not appear to be objectionable by the EC (actually, it is worthwhile noting that, when raised by regulatory authorities of other European countries, the EC remained silent on this subject[7], therefore allowing them full margin of discretion when choosing the appropriate model for calls originated outside the EEA). Hence, Ofcom's decision should be guided by what is best for UK customers and businesses rather than looking at simplifying its regulatory burden[8].

At Annex 11 Ofcom undertakes a superficial analysis of three different options for the treatment of MTRs i.e. (i) no differential regulation, (ii) exclude the termination of non-EEA originated calls from the MCT charge and (iii) reciprocity condition for non-EEA originated calls.

[6] Ofcom consultation on mobile call termination market review 2018-21 at Annex 11, A11.1.

[7] For instance, see cases AT/2015/1801-180211, where the TKK [Austrian Regulatory Authority] proposed to modify the scope of the obligation of price control, and limit it to calls originating within the European Economic Area (EEA). The Commission had no comments and case HR/2016/1892: Wholesale voice call termination on individual mobile networks in Croatia.

[8] See for example reference at A11.59 and A11.61

The analysis appears to be mainly speculative and not supported by any evidence. For instance, at A11.55, Ofcom declares that *if UK MTRS increased under differential regulation this could pass-through to retail prices in non-EEA countries leading to fewer calls to UK consumers and business.* Ofcom does not have any evidence that this will be the case. In fact, Ofcom appears to be just guessing what the reaction of non-EEA consumers and providers would be without any real insight on their consuming behaviour and/or their pricing structure.

Moreover, Ofcom indicates that, according to their estimates, UK MCT providers' total gross termination and transit payments for calls to outside the EEA are approximately £40m per annum and that their gross termination revenues for calls from outside the EEA are approximately £4m per annum. Ofcom acknowledges that this is a huge difference, however it tries to dismiss this imbalance with a comparison between the gross termination revenues for call from outside the EEA and the total sector revenues (that were of £15.3bn)[9]. In O2's view, such a comparison is meaningless. The total sector revenue includes many things, so we cannot take into consideration this number to say that the revenues outflows were minimal. Hence, for the sake of coherence, only the revenue outflows and inflows for calls termination should be considered. A simple glance at these figures throws two possible interpretations: i.e. either that (i) UK customers do not receive many international calls from outside the EEA (which in itself appears quite ridiculous) or (ii) that by imposing this maximum charge control, Ofcom is forcing UK MNOs to subsidize non-EU providers, to the detriment of their own customers (given the existence of a "waterbed").

In O2's views, reciprocity (iii above), which allows operators to freely negotiate the terms and conditions applicable to their relationship on a bilateral basis, is likely to be the best option. Reciprocity is successfully used on wholesale roaming charges outside the EEA and it is worthwhile to note that wholesale roaming prices are below the regulated rate. There is no reason to think that MCTRs would not follow the same path.

**Question 6.1: Do you agree with our proposed approach to implementing the MCT charge control? If not, please discuss the specific proposals that you disagree with.**

In the event that Ofcom ultimately concludes that it is appropriate to reduce MTRs from their current level, O2 strongly believes that this reduction should be implemented by way of a three year glide path, rather than a one-off adjustment as proposed in the MCT Consultation.

Ofcom's approach is to argue that *rates should fall to LRIC as quickly as possible (in order for the benefits of MTRs al LRIC to be realised quickly)*[10]. However, Ofcom acknowledges that *many post-pay subscribers will be committed to existing contracts at the start of the first year of the change control.* Surprisingly, Ofcom decides that this does not matter because *providers would have sufficient opportunity to recover efficiently incurred costs by making adjustments to other prices if necessary*[11]. This observation provides no insight as to which the other prices they are referring to are and to the speed at which providers and customers can adjust to new levels of wholesale charges.

O2 believes that Ofcom's proposal not to adopt a glide path to move to the new estimate of pure LRIC is a mistake and will undermine regulatory certainty (as it constitutes an unjustified departure from Ofcom's well established previous practice) while it will also be in detriment of the MNOs' incentives to invest.

[9] Annex 11, at A11.14
[10] Ofcom consultation on mobile call termination market review 2018-21 at 6.20.
[11] Ofcom consultation on mobile call termination market review 2018-21 at 6.23.