Fixed Narrowband Market Review

EE Response

2 April 2013

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1. Introduction and summary

This document provides Everything Everywhere's (EE) response to Ofcom's consultation in relation to the Fixed Narrowband Market Review (FNMR).[1] Ongoing appropriate and proportionate regulation of the wholesale services covered by this market review remains an essential part of the overall regulatory regime. As Ofcom recognises, fixed telephony services continue to be important to meeting the communications needs of UK consumers. EE is the largest UK mobile operator, but also has a significant (and growing) fixed line business. The growth in mobile only households has stalled in recent years and mobile and fixed communications services are increasingly considered as complements. Especially as new technologies increase their penetration, it therefore remains important to ensure that there is an appropriate regulatory regime in place which protects and promotes competition, to the ultimate benefit of end consumers.

EE's key points are as follows, which points are expanded upon in the rest of this response.

- BT continues to play a central part in voice markets in the UK and vibrant retail competition is reliant on ensuring appropriate wholesale regulation.
- EE continues to believe that fixed non-geographic call termination should be part of fixed call termination market and that Ofcom's analysis excluding it is flawed. EE considers that it is premature for Ofcom to reach a decision now as to whether the termination of non-geographic calls will or will not fall within a broader market for the termination of other fixed calls over the period covered by this FNMR.
- EE continues to consider that LRIC+ is the right benchmark for setting termination rates. But given that mobile termination rates are now based on a pure LRIC measure, fixed termination rates should be based on the same methodology as soon as possible.
- The common costs no longer recovered from call termination should not be solely recovered from wholesale call origination charges. This places BT at a competitive advantage and has not been justified in the Consultation. These common costs should at least in part, if not completely, be recovered from retail charges as well.
- If call termination is to be based on NGN/IP costs, Ofcom needs to provide more reasoned and clearer guidance and/or regulation of charges to recover the conversion costs between IP and TDM traffic.
- EE agrees with Ofcom that fixed termination charges should be reduced to pure LRIC levels as soon as possible and does not consider that there is any justification for not doing so. Mobile termination rates are already at pure LRIC levels.

[1] Review of the fixed narrowband services markets: consultation on the proposed markets, market power determinations and remedies", Ofcom consultation published on 5 February 2013 (the Consultation).

- EE remains concerned that Ofcom continues to impose cost orientation remedies on a market review by market review basis. This is in advance of the long promised document on how Ofcom proposes to use and apply such remedies. The issues raised by cost orientation apply across several market reviews and consistency would be beneficial. Applying changes piecemeal in individual market reviews is therefore not an appropriate approach Even if cost orientation is not applied here, publication of cost benchmarks remains an important source of information for purchasing CPs and should continue to be published.

The remainder of this response comprises the following sections:

- Section 2 summarises our high level views on the market analysis contained in various sections of the Consultation (detailed comments are provided in answer to the specific consultation questions);
- Section 3 sets out EE's comments on the treatment of non-geographic numbers in the current market review;
- Section 4 comments on the proposed charge controls in relation to wholesale call origination and termination;
- Section 5 provides our remaining high level comments on the other remedies proposed; and
- Section 6 provides answers to the specific consultation question.

2. Ofcom's market analysis

Overall, EE agrees with the principal conclusions in the Consultation that there is currently effective competition in the retail sector, that wholesale call termination and call origination constitute separate markets and that BT continues to have significant market power (SMP) in these wholesale markets.

EE does not consider that retail competition can be taken for granted. Some retail prices (especially line rental charges) have been increasing in the recent period, notwithstanding Ofcom's broad brush statistics showing overall falling fixed prices (up to 2011). Retail competition also continues to rely on wholesale inputs from BT of differing types. Virgin Media only covers around half the country's homes, and it seems likely this will remain the case for at least the duration of the current market review. All other significant competitors rely in one way or another on BT's network.

Due to its historical position, BT also retains a central part in call termination in the UK, being the main transit operator. It would be neither commercially nor practically possible for all operators to interconnect with all other operators, regardless of size and volumes of traffic. BT therefore has a vital role to play as a hub which enables the vibrancy and depth of competition in the UK telecoms landscape to be maintained.

Looking forward, with the increasing migration to next generation access products, BT will continue to retain a strong wholesale and retail position. Ensuring competition is able to thrive in this environment will be important. Fibre based products will continue to need to be provided alongside distinct voice services (potentially for the duration of the proposed market review period): under current arrangements voice will still be best carried over copper circuits for competing providers.

Against this background, the combination of the regulation resulting from this review and the Fixed Access Market Reviews[2] will be crucial in ensuring that competition at the retail level can be maintained and promoted.

3. Calls to non-geographic numbers

EE considers that Ofcom should not explicitly exclude fixed non-geographic call termination from the fixed call termination market based on its flawed analysis in paragraphs 6.24-6.27 (EE's concerns with Ofcom's reasoning are set out below). This analysis and finding has the potential of incorrectly prejudging the parallel NGCS review and is in any event superfluous to the timely introduction of remedies on fixed geographic call termination from October 2013.

EE agrees with Ofcom that the parallel NGCS review currently proposes fundamental changes to regulation of non-geographic calls.[3] EE remains of its longstanding view that Ofcom should define the wholesale market for termination of non-geographic calls and consider any appropriate remedies at this level, *before* the need for any of the retail level remedies contemplated in the NGCS review is considered and/or such remedies are implemented. However, assuming that Ofcom does nevertheless press ahead with its NGCS reform proposals and these are not challenged, clearly such proposals have the potential to significantly alter the current competitive landscape. EE therefore considers that it is premature for Ofcom to reach a decision in its FNMR as to whether the termination of non-geographic calls will or will not fall within a broader market for the termination of other fixed calls over the period covered by the FNMR. Rather, this should be left until the next FNMR, when the impact of the NGCS reforms can be factored in to this assessment[4].

In addition to being premature, EE is also concerned that the analysis set out in the Consultation that excludes the non geographic call termination market from the geographic termination market is fundamentally flawed. These concerns stem from the following.

Lack of evidence substantiating Ofcom's conclusions

In the Consultation, Ofcom simply, *asserts* that

2 See "Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30: Call for inputs", published 9 November 2012 and "Review of the wholesale broadband access markets: Call for Inputs" published 9 November 2012.

3 See paragraph 6.43 of the Consultation.

4 Alternatively and preferably of course, Ofcom can do this in a detailed fashion as an integral element of its NGCS review.

> "…*CPs face different competitive constraints when setting termination rates for calls to non geographic numbers within their number ranges than they do to calls to geographic numbers*."[5]

However the evidence for this view is not presented. Rather, Ofcom simply refers to a number of factual differences that appear to distinguish the services of geographic and non-geographic call termination without investigating the true extent of these differences and/or whether they actually make a material difference to the competitive dynamic between originating CPs and TCPs in the relevant market(s).

First, Ofcom argues that because CPs offering non-geographic call termination offer value added services, including sophisticated routing and multiple points of termination, there is a "*much greater*" potential for competition between TCPs in providing these services.[6] However Ofcom provides no evidence for these assertions. While value added services such as dynamic routing may be sought by some large and sophisticated SPs such as banks and utilities, EE suspects that in many cases TCPs will simply host non-geographic numbers and/or resell them to SPs without providing these features.[7] In the case of corporate landline customers, there are also a number of sophisticated call management services such as termination to mobile numbers that can be attached to the customer's geographic fixed termination number.[8] It is therefore not clear whether and if so to what extent this feature does actually competitively distinguish geographic and non-geographic fixed termination services.

Second, the assumption that TCPs will be influenced by the preferences of their SP customers when setting gross termination rates to originating CPs on the grounds that SPs can switch TCPs runs counter to the observed current workings of the relationship between originating CPs and TCPs regarding the termination of non-geographic calls. Ongoing disputes involving mobile originating CPs on the one hand and BT and other fixed TCPs who have increased non-geographic termination charges multiples above geographic termination rates on the other hand have demonstrated that large increases in gross termination rates do <u>not</u> <u>have any clear or necessary</u> impact on net termination payments (i.e. outpayment levels to SPs remain the same). To the extent that SPs remain unaffected by changes to the charges imposed by TCPs on originating CPs, SPs therefore have no incentive to switch away from / to TCPs in response to higher gross termination rates and thus exert no competitive constraint on these charges. In Ofcom's NGCS review, a claimed lack of SP ability to control the charges set at the originating CP level is currently a key underlying justification used by Ofcom to support its tariff

5 See paragraph 6.25 of the Consultation.
6 See paragraph 6.26 of the Consultation.
7 Ofcom has previously identified that that small organisations and individuals would be likely to provide basic number translation services only (paragraph 2.11 of the NCCN 500 Decision, August 2008). Ofcom has not, to EE's knowledge, suggested these groups would also be offering value added services.
8 See for example: http://business.orange.co.uk/home/small/products-and-services/services-and-accounts/voice-services/pocket-landline?WT.mc_id=pocket_landline_customer_portal_0211

unbundling proposal on 08x and 09 number ranges. Yet the FNMR contradicts its own NGCS review analysis on this issue.

Finally, when claiming that the wholesale termination market for geographic calls excludes NTS calls, Ofcom argue that competitive conditions are different for NTS calls owing to SPs' ease of switching between TCPs[9]. Yet when examining the wholesale cal origination market, Ofcom claim migration costs limit the effectiveness of SPs to substitute to alternative networks for non geographic calls, thereby placing non geo and geo calls in the same wholesale cal origination market owing to similar competitive conditions.[10] Clearly, Ofcom cannot have it both ways and one of these propositions must be false. EE considers that Ofcom's far more reasoned and detailed conclusions regarding the wholesale fixed call origination market regarding the barriers to switching by SPs are to be preferred.

SSNIP test and supply side substitutability

In the Consultation, Ofcom also seeks to establish separate markets for the termination of fixed geographic and non-geographic calls on the basis that there are some TCPs who terminate non-geographic calls that are not active as TCPs who terminate geographic calls. [11].

To the extent that different TCPs terminate non-geographic calls, far from suggesting separate markets, EE considers that this result is in fact suggestive of additional substitutability constraints, which could be tested under a supply-side SSNIP test.

Supply-side substitution arises where there are additional constraints on TCPs beyond those already captured by demand-side SSNIP analysis. One example of where this arises is where there are additional TCPs not already materially present in the supply of fixed geographic termination, but providing services for close supply side substitutes (i.e. non geographic call termination).

If Ofcom applied a 5-10% SSNIP increase in geographic termination rates, and found that this would be likely to encourage entry from TCPs who terminate non-geographic calls but who do not currently provide geographic call termination, this could suggest non-geographic termination is in the same market.

Ofcom needs to explain why it has chosen not to apply a supply-side SSNIP test, especially where TCPs providing close substitute services are not present in geographic termination and would clearly provide an additional constraint on pricing not factored into the demand-side SSNIP test.

Further interim issues

In the Consultation, Ofcom states:

9 See paragraph 6.26 of the Consultation.
10 See paragraph 5.281 of the Consultation.
11 See paragraph 6.25 of the Consultation.

"*In April 2012, Ofcom proposed a new form of NTS regulation. Under this approach, known as the 'unbundled tariff' remedy, a new call charge structure which separates the retail price of a non-geographic call into two different components would be implemented*"[12]

…."*Separating the wholesale call origination charge (Access Charge) from the revenue to the TCP and SP (Service Charge) removes any concerns that BT could use its SMP in wholesale call origination to restrict the revenue received by TCPs and SPs for termination. Therefore, we do not consider it necessary to retain the specific additional NTS Call origination Condition following the implementation of this unbundled tariff*."[13]

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"*Any suitable interim remedy must continue to safeguard competition in the market for NTS. Given the relatively short period of time for which it may be required, though, it must also be proportionate.*"[14]

EE has the following comments to make on the interim period between the proposed removal of the current NTS call origination condition on BT and the introduction of the unbundled tariff regime.

First and foremost, EE considers that the NTS call origination condition <u>should continue to apply in the interim period</u> until the unbundled tariffs are implemented.

The current NTS origination charge control was published in July 2011, to apply for a period of just over two years, until September 2013. Currently, Ofcom's final statement on NGCS reform is not expected to be published until April 2013, with a period of time to then follow before Ofcom publishes the relevant legal instruments for consultation and then in final form. It is thus entirely conceivable that the period for implementation of any tariff unbundling regime under Ofcom's NGSC reform proposals does not commence until September 2013, with a further 18 month time period granted for implementation (as per Ofcom's current proposals). To the extent that Ofcom considered it appropriate and proportionate to set a detailed NTS call origination charge control for the circa 2 year period between July 2011 and September 2013, EE considers that it is equally appropriate and proportionate for Ofcom to do the same thing for the circa 18 month period between September 2013 and March 2015.

EE considers that Ofcom's proposed RPI cap provides far too much allowance for cost inefficiencies and is a highly inappropriate substitute for a detailed cost based charge control.[15] As an alternative, EE considers that one option is to set a stricter price control on NTS call origination that makes the reasonable assumption that improving network efficiencies and falling equipment prices are at least offsetting RPI increases. This analysis suggests that, if Ofcom is not going to impose a detailed cost based charge control, a broad brush RPI-RPI control would be more appropriate and would incentivise BT to make efficiency

12 See paragraph 2.284 of the Consultation.
13 See paragraph 5.285 of the Consultation.
14 See paragraph 5.286 of the Consultation.
15 See paragraph 5.291 of the Consultation.

savings equal to the increase in inflation. EE notes that Ofcom has applied similar controls in the context of the BCMR and hence a precedent for such a control exists. BT must continue to face a suitable proxy for competition in the lead up to the unbundled tariff regime.

Second, the fact that the unbundled tariff regime will not be implemented for at least 18 months from the date of publication of Ofcom's final legal instruments, could suggest that the LRIC+ proposals for the NCC (scheduled to become effective October 2013) could potentially impact the value chain for both NTS call termination and NTS call origination in the interim period. In particular, competition is likely to be adversely impacted in the interim period, especially for non-geographic numbers which are presently priced at a low level (e.g. 0843/4/5), and which the LRIC+ control may increase relatively more than other NGN call types.

For this reason, Ofcom should require BT to recover more common costs from BT's other commercial services, including its own retail fixed products, to better meet efficient cost recovery principles. Given the approach taken in the context of mobile call termination across the EU (including the UK), where it is argued for common costs to be recovered via the competitive retail market, and given Ofcom's objectives to regulate on a technologically neutral basis, pass through of an allocation of the common costs by BT to its retail services would ensure a more consistent approach as between the fixed and mobile call sectors.

Finally, even after the unbundled tariff regime has been implemented, EE argues that the assertion that unbundled tariff will sufficiently constrain BT prices as a wholesale originator of NTS traffic is a controversial assertion at best, and more importantly untested. EE argues that the NTS call origination condition should only be removed once the competitive pressures on BT claimed by Ofcom for the new regime are evidenced.

4. Proposed charge controls

Cost modelling and cost benchmarks

Ofcom's broad bottom up cost modelling approach which is based on Next Generation Networks (NGN) costs, but which does not formally deem NGN as the modern equivalent asset seems a reasonable and proportionate compromise position. It is not necessarily a long term approach but EE would agree it is a sensible approach for the current market review, given the uncertainties about the way in which networks will develop.

EE also believes Ofcom is correct to consider these issues in terms of balancing different types of efficiency (allocative, productive and dynamic) and ensuring competition. This will mean that it is important to ensure that using NGN based costs does not lead to charges which are higher than they would otherwise be if based on TDM networks (which would not promote either efficiency or competition). EE considers that Ofcom should make some kind of assessment to ensure this is the case, which does not appear to have yet been done.[16]

As EE stated in its response to the Call for Inputs[17] it continues to believe that LRIC+ is the right benchmark on which to set termination rates more generally. However, UK mobile termination rates are now confirmed as being set on a pure LRIC basis and reached this benchmark on 1 April 2013. Glide paths down to pure LRIC termination rates are also now being set in a number of other European jurisdictions (although EE notes that the German NRA has still proposed setting termination rates based on a LRIC+ benchmark and this is currently being considered by the European Commission, BEREC and national regulators). BEREC has recently issued an opinion confirming serious doubts in relation to fixed termination rates in Italy on the basis that pure LRIC rates would not be reached until 2015 under the NRA's approach.[18] Given this background it is clearly vital that fixed termination rates in the UK are set on the same basis as mobile termination rates and in the same manner as fixed rates in other EU countries. The same basic methodology must be used to ensure technology neutrality – and competitive neutrality to the extent that fixed and mobile services compete with each other (where the Consultation finds that there is an indirect constraint between the two sectors).

Basing the regulation of wholesale call origination charges on a consistent basis, using the same model and a LRIC+ cost benchmark also seems appropriate. Again, it is important that the underlying efficiency and competition goals are also promoted through any such approach. EE would therefore expect (leaving aside the issue of the recovery of common costs no longer recovered from termination rates, which is discussed further below) that the move from a Current Cost Accounting Fully Allocated Cost basis to a LRIC+ basis would not lead to any increase in the underlying costs being recovered. This is not straight forward to ascertain from the Consultation but appears to be the case.

EE's views on the specific input assumptions which Ofcom proposes using in the cost modelling are set out in answer to specific consultation question 9.1 in section 6 of this response.

Common cost recovery

Moving from a LRIC+ cost benchmark to a pure LRIC benchmark for call termination rates means that there are common costs which are no longer recovered from call termination charges which need to be recovered elsewhere.

16 Although EE recognises that it is unlikely to be proportionate to develop two completely separate models based on each of NGN and TDM technologies to assess this issue.

17 See section 3 of EE's response, dated 28 June 2012, to "Fixed Narrowband Market Review and Network Charge Control: Call for inputs".

18 "BEREC Opinion on Phase II investigation: Case IT/2013/1415Call termination on individual public telephone networks provided at a fixed location (market 3) in Italy," published 25 March 2013. In particular BEREC considers "AGCOM has not provided a valid justification for deviating from the EC recommendation and, in particular, has not provided evidence which supports its view that applying pure BU-LRIC tariffs from 2013 would have a disproportionate effect on Italian operators."

As the Consultation notes, this was naturally also an issue in relation to the setting of mobile termination rates and mobile operators have now to recover these common costs from retail charges.[19]

The Consultation asserts that the situation is different in relation to the fixed industry, essentially because there are competitors based on wholesale products who are not impacted by the change in termination rates but who purchase wholesale call origination.

Ofcom identifies three potential options for the recovery of this tranche of common costs on the Consultation, essentially to recover these costs:

1. Entirely from unregulated (which will include retail) charges;
2. Entirely from regulated charges; or
3. Some combination of the two.

The main body of the document includes a lengthy discussion of this issue and the above options (in light of various stakeholder comments to date). It concludes somewhat ambiguously in paragraph 8.78:

> *"we propose to regulate wholesale call origination on the basis of LRIC+, but where the "+" will include an additional contribution to common costs no longer recovered from FTRs at LRIC"*

This statement does not make clear whether option 2 or 3 of the list above is being chosen. However, this is made clear in the detailed explanation of the proposed methodology in Annex 12.[20] The approach clearly set out there is that all of the common costs no longer recovered from call termination will be added to (regulated) wholesale call origination charges. i.e. Ofcom has clearly chosen option 2.

A related question is from <u>what</u> regulated charges these common costs are recovered. Ofcom considers whether to recover these costs from WLR rental charges or wholesale call origination charges. EE strongly agrees with Ofcom that the former would not be appropriate. The distortions this would cause, essentially for the reasons set out in the Consultation, would harm both efficiency and competition. In the context of migration to FTTC based products, there would also be an additional potential distortion from increasing WLR charges in this way. At least in the near future, WLR is likely to be needed to be taken in conjunction with fibre based broadband products in order to provide a voice service. Increasing WLR charges in this way would therefore distort this migration adversely.

On the question of whether option 2 (recovering all of these common costs from regulated charges), EE disagrees that Ofcom has struck the right balance.

- BT has supported a mix where some of these charges are recovered from unregulated charges;[21]

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19 See paragraphs 8.41-3 of the Consultation.
20 See especially paragraphs A12.208 to A12.211 of the Consultation.
21 See paragraph 8.56 of the Consultation summarising BT's response on this issue.

- the Consultation does not set out clear reasons why option 2 has been chosen over option 3 (most of the argument set out in the document relates to why option 1 is inappropriate);
- given that there is some indirect competition between the fixed and mobile sectors, Ofcom does not explain why technology neutrality principles do not mean that at least some of these costs are left to be recovered from retail services (more consistent with the approach already imposed on mobile operators); and
- as EE noted in its previous responses in this market review,[22] BT clearly has had the ability to raise retail prices (especially line rental charges) in recent times and the Consultation does not demonstrate why it would not be able to recover at least a significant proportion of these costs from retail charges and why this would in practice create any harm to competition.

TDM/IP Conversion Costs

The Consultation essentially proposes that traffic is assumed to be passed between operators on an IP basis and BT will be able to negotiate commercially any costs of conversion of TDM traffic.[23] This is clearly a fundamental change to the current arrangements where any costs of conversion are included within the regulated charge. In principle, EE does not have strong views on changing the underlying basis on which charges are calculated. However, it will be important that the costs of conversion are treated appropriately. It is not clear that these costs will be determined in a competitive market. Ofcom's current indication that it will assume such costs should be divided equally between the interconnecting parties also raises more questions than it answers.

Conversion costs should be assessed on the basis of competitive neutrality, efficiency and cost causation, in line with Ofcom's statutory duties. A blanket indication that such costs should simply be split between the interconnecting parties does not necessarily lead to the most efficient or competitive outcome. EE considers that operators should only be able to recover their efficiently incurred conversion costs and that these costs set appropriate and reasonable incentives for operators.

As Ofcom notes, parallel running of IP and TDM networks is likely for some time (and at least for the duration of the current market review period). This may well represent an efficient outcome. The proposals in the Consultation are effectively a half-way house, where Ofcom states that it will leave the determination of such charges to commercial negotiation but provides a very high level view on how it intends to resolve any resulting disputes. EE considers that Ofcom should either determine what the appropriate level of these costs are through regulated charges, or state that each case will be determined on its merits through the dispute resolution process. Any guidance

22 See section 3 (especially pages 5-6) of EE's response, dated 28 June 2012, to "Fixed Narrowband Market Review and Network Charge Control: Call for inputs".

23 Annex 11, from paragraph 11.113.

on how Ofcom expects to resolve such disputes needs to be properly assessed, reasoned and consulted upon. Simply asserting that such costs are likely to be split between the interconnecting parties does not provide appropriate reasoned guidance. For example, it is not clear to EE how transit situations will be considered.

Form and structure of the charge control

EE agrees with the glide path proposed in the Consultation for fixed termination rates (bringing them in line with pure LRIC as soon as possible). The proposed date by which rates should reach these levels under the European Commission (EC) recommendation on termination rates has now passed and mobile termination rates are already at the level implied by pure LRIC. Given this, there would seem to be no reason for fixed termination rates to continue to be set above pure LRIC for any significant period of time. This would lead to a continuing period where different parts of the industry were regulated on a different basis solely arising from the accident of different timings of market reviews.

Further, as noted in the Consultation, the flat rate cap regulation of mobile rates implied a two year glide path and therefore there is no justification whatsoever for a three year glide path for fixed termination rates. EE also notes and agrees with Ofcom's comments in relation to the differential scale of the impacts on the mobile and fixed sectors of the termination rate cuts.

In the mobile termination rate appeals, BT argued[24] that rates should be cut to pure LRIC levels as soon as possible in line with the EC recommendation unless good reasons could be provided for departing from it and that a shorter glide path was a superior solution to achieve the alleged benefits of pure LRIC based rates. The same logic applies to fixed termination rates and supports a one off cut, given that BT was well aware of how the recommendation would apply to fixed termination rates whilst proffering such arguments.

While it is true that the CC also found that a one-off adjustment was not appropriate for mobile termination rates, the context of this decision needs to be taken into account. The CC explicitly noted that this was not appropriate where mobile operators had a reasonable expectation of a glide path based approach and the possibility of an initial one off cut had not been raised during the consultation period. This is manifestly not the case in relation to fixed termination rates where this possibility has been explicitly raised by a number of parties early on in the consultation process and where there is a clear precedent from the mobile termination rate market review that pure LRIC rates will be applied as soon as possible. Ofcom also explicitly identified a potential disruption to mobile retail prices from too rapid an adjustment in the mobile

[24] See section 5 of the Competition Commission's Final Determination in relation to the Reference under section 193 of the Communications Act 2003 of the cases British Telecommunications plc v Office of Communications (Case 1180/3/3/11), Everything Everywhere Limited v Office of Communications (Case 1181/3/3/11), Hutchison 3G UK Limited v Office of Communications (Case 1182/3/3/11) and Vodafone Limited v Office of Communications (Case 1183/3/3/11).

context (on which the CC placed some weight), which risk the current Consultation does not identify in the fixed context.

In conclusion, there is no justification for fixed termination rates to be set using a different methodology for any longer than absolutely necessary. Mobile termination rates are now set on a pure LRIC basis and fixed rates should be set using the same approach at the start of the next charge control. This is entirely consistent with the conclusions of the CC in their determination on mobile termination rates and, *a fortiori*, consistent with the arguments BT made in their appeal of the mobile termination rates market review.

The Consultation also proposes that fixed termination rates continue to be regulated by means of a basket form of charge control (allowing flexibility on the setting of different rates at different times of day under the overall basket cap). Mobile termination rates are now regulated by a flat rate cap. Given this it would be simpler and ensure consistency across the electronic communications sector if the same approach was used for fixed termination rates. Increasingly time of day differentials are also becoming less important in retail pricing across the sector making such a move also consistent with this wider retail pricing trend. In the absence of a compelling reason to retain the ability for time of day wholesale charging gradients, EE considers it makes more sense for the form of charge controls to be consistent across mobile and fixed markets.

5. Other remedies proposed

Cost orientation

The Consultation proposes no cost orientation obligations. Broadly, cost orientation is likely to be more of a substitute to other charge controls than a complement in the context of this market review. For this reason, EE does not have strong views either way on whether cost orientation obligations are used in conjunction with price caps in these specific markets. However, EE remains concerned that Ofcom is developing its approach piecemeal to the cost orientation remedy generally on a market review by market review basis. As EE has noted in previous responses, Ofcom had intended to publish a more general document considering the appropriate way to use this remedy. Such a document has still not been published, although we now understand it is still due to be published in the coming weeks. This uncertainty around Ofcom's policy development undermines the efficacy of remedies and confidence in regulatory certainty. Ofcom appears to have decided on a general policy change towards cost orientation and is removing remedies of this type in a number of market reviews. The overall rationale for this approach is not clear.

In the context of this market review, the Consultation uses the different treatment of common costs (discussed in the previous section) as one of the justifications for not imposing a cost orientation remedy. This is puzzling as the mere fact that the balance of common cost recovery is changing between products does not provide a justification in itself for not using cost orientation. If a greater proportion of common costs are being recovered from a particular service (in this case wholesale call origination) than previously the stand alone cost ceiling remains an appropriate benchmark. Arguably more so, given that charges will presumably be closer to this ceiling and therefore it becomes more likely to be an important and binding constraint, especially in the context of a basket based charge control where individual charges are not being determined.

Overall, EE considers that Ofcom needs to set out its approach to the use of cost orientation as a remedy in more reasoned detail. Given the number of market reviews where cost orientation is being dismissed as inappropriate this is now becoming a matter of urgency and a source of regulatory uncertainty.

On the assumption that there is no cost orientation remedy, EE also remains of the view that this does not remove the requirement for cost accounting remedies requiring the publication of cost benchmarks (stand alone cost ceilings and LRIC floors). This approach, explicitly copied here from the Business Connectivity Market Review,[25] is not justified. Purchasing CPs should still be able to understand the extent to which individual prices are related to costs. Merely knowing the relationship of a price to fully allocated cost is not sufficient. This provides no information on whether individual charges are within reasonable bounds. Understanding how far (or near) actual charges are from a stand alone cost ceiling ensures that CPs negotiating with an SMP operator are placed in a more equal bargaining position. Otherwise, the SMP operator is more able to provide a take it or leave it price. EE expects that this removal of cost information will tend to lead to more disputes being referred over time and urges Ofcom to rethink its general approach in relation the publication of cost accounting information especially.

In the markets covered by this market review, such information will be important for wholesale based competitors to be able to ascertain that there is no undue discrimination arising from increasing call origination charges. It will enable such CPs to understand whether or not this leads to inappropriate margins between wholesale and retail prices. Making such an assessment is likely to be a complicated issue, especially given widespread bundling of prices at the retail level and the range of wholesale charges (both in terms of the different levels of individual wholesale charges, for example at different times of day, and in relation to the different structure of wholesale charges compared to retail charges). Removing the cost information available to assess these issues will be a retrograde step, likely leading to greater confusion and more potential complaints.

Proposed changes to notice periods

Ofcom is proposing a change to current notice periods for price charge changes by BT and KCOM, whereby the current conditions, which require a 90 day notification period in advance of such changes, will be reduced to 56 days (paragraphs 5.151; 10.104; 10.195).

Given the limited human, financial and IT resources to monitor and implement wholesale and retail price changes faced by EE and no doubt many other CPs,

[25] See, for example, paragraph 6.171 of the Consultation.

EE is not able to agree with Ofcom's conclusion that this notice period will allow CPs to reflect such price changes in their retail prices "*without incurring any commercial risk*" (paragraphs 5.224; 6.156).

In relation to Ofcom's claim that: "*Most respondents coalesced around a 56 day notice period for charges, primarily by reference to a desire to have symmetric notice periods between themselves and BT*" (paragraph 2.31), EE considers that some further explanation is necessary. Specifically, under paragraph 12 of the SIA, BT only provides CPs with a minimum of 28 days' notice of changes to charges for BT services provided under the SIA that are not subject to a longer mandatory notification period by Ofcom. EE considers that this notice period is unreasonably tight, as it makes it virtually impossible for CPs such as EE to reflect wholesale price increases from BT in their retail pricing before the wholesale price changes come into effect. What EE desires (and what EE believes many other CPs similarly desire) is for this 28 day notice period for price changes to BT services under the SIA to be <u>increased</u>, to a minimum of 56 days notice. In particular this is an issue for EE in relation to the charges that EE pays to BT for the termination and transit of calls to non-geographic numbers, the prices of which have historically been subject to huge price spikes (e.g. for calls to 118 118).

Commercially, BT made an offer to industry some time ago to agree to increase the notice given on changes to prices for all "BT Services" under the SIA to 56 days, on the proviso that the notice period for BT's regulated prices would be decreased from 90 days to 56 days. However, as at 2 April 2013, BT has withdrawn this offer, and is now only proposing to increase the notice given for fixed geographic calls terminated on BT's network under the SIA. This far more limited offer in no way meets the commercial objectives behind EE's preparedness to consider supporting a reduction in the notice for changes to prices for BT's regulated services to 90 days in the form of a quid pro quo.

6. Answers to specific consultation questions

Market developments in retail services excluding the Hull Area

Question 3.1: *Do you agree with our assessment that both the business and residential retail fixed narrowband calls markets in the United Kingdom have remained competitive since 2009 and that we expect the same competitive conditions to continue during the period of this review as long as appropriate wholesale regulations remain in place? If not, please explain why.*

Broadly EE agrees that retail fixed telephony markets remain competitive, but urges Ofcom not to take this for granted and ensure that appropriate and proportionate regulatory arrangements continue to be in place. This will be necessary to ensure competition can be maintained. Ofcom will need to ensure this across both this market review and the concurrent Fixed Access Market Reviews.

Market developments in retail services in the Hull Area

Question 4.1: *Do you agree with our assessment that no material changes have occurred in the retail markets in the Hull Area since the last review in 2009? If not, please explain why.*

No comment.

Question 4.2: *Do you agree with our assessment that ex post competition law remedies would now be sufficient to address any competition concerns identified during the period covered by this review and that it would no longer be appropriate to maintain regulation for retail narrowband call services in the Hull Area? If not, please explain why.*

No comment.

Wholesale call origination

Question 5.1: *Do you agree with our assessment that the relevant service market is "Wholesale call origination on a fixed narrowband network"? If not, please explain why.*

EE agrees that this is a reasonable basis for considering the appropriate remedies for this market review period.

Question 5.2: *Do you agree with our assessment that there are two relevant geographic markets: "The United Kingdom excluding the Hull Area" and "The Hull Area"? If not, please explain why.*

No comment.

Question 5.3: *Do you agree with our assessment that BT has SMP in the market for "Wholesale call origination on a fixed narrowband network" in the United Kingdom excluding the Hull Area? If not, please explain why.*

EE agrees that BT retains SMP in this market.

Question 5.4: *Do you agree with our assessment that KCOM has SMP in the market for "Wholesale call origination on a fixed narrowband network" in the Hull Area? If not, please explain why.*

EE agrees that KCOM retains SMP in this market.

Question 5.5: *Do you agree with the remedies imposed on BT in the market for "Wholesale call origination on a fixed narrowband network" in the United Kingdom excluding the Hull Area? If not, please explain why.*

See sections 3, 4 and 5 above.

Question 5.6: *Do you agree with the remedies imposed on KCOM in the market for "Wholesale call origination on a fixed narrowband network" in the Hull Area? If not, please explain why.*

See sections 3, 4 and 5 above. EE has no further comments specifically in relation to the proposed remedies on KCOM.

Wholesale fixed geographic call termination

Question 6.1: *Do you agree with our assessment that the relevant service market is "termination services that are provided by [named fixed communications provider] (CP) to another communications provider, for the termination of voice calls to United Kingdom geographic numbers which that CP has been allocated by Ofcom in the area served by that CP"? If not, please explain why.*

EE welcomes Ofcom's acknowledgement that the EC does not explicitly exclude call termination to non-geographic numbers from the relevant fixed call termination market (at 6.43). EE does not agree with the analysis which leads Ofcom to formally exclude fixed non-geographic call termination from this market for the reasons given in section 3 of this response.

Otherwise, EE agrees with the proposed market definition and with aligning it with the approach taken to defining mobile call termination markets.

Question 6.2: *Do you agree with our assessment that the relevant geographic market is determined by reference to the area in which the CP provides termination services and is not wider than the United Kingdom? If not, please explain why.*

No comment.

Question 6.3: *Do you agree with our assessment that each CP has SMP in the market for fixed geographic call termination to their number range? If not, please explain why.*

Given the approach taken to mobile call termination, EE agrees that a consistent approach should be taken to fixed call termination.

Question 6.4: *Do you agree with the remedies imposed on BT in the market for fixed geographic call termination to its number range? If not, please explain why.*

See sections 3, 4 and 5 in the main body of this response. EE remains of the view that termination rates should be based on a LRIC+ cost measure. Given that mobile termination rates are now set on a pure LRIC basis, EE considers it is important, for reasons of technology neutrality, that fixed termination rates are set using a consistent methodology.

Question 6.5: *Do you agree with the remedies imposed on other CPs (excluding BT) in the market for fixed geographic call termination to their number range? If not, please explain why.*

The approach to remedies on fixed geographic call termination for CPs other than BT proposed in the Consultation appears consistent with the approach taken to mobile call termination. Effectively continuing a reciprocal approach based on a benchmark fixed termination rate appears reasonable and proportionate.

For the avoidance of doubt EE would also request that Ofcom confirm that the benchmark fixed termination rate referred to in the guidance on whether mobile termination rates for operators who provide traffic “over the top”[26] is the same as the benchmark fixed termination rate in this guidance.

Transit and conveyance services

Question 7.1: *Do you agree with our assessment that there have been no material changes in the ST market since the 2009 review? If not, please explain why.*

Yes.

Question 7.2: *Do you agree with our assessment that ex post competition law remedies would now be sufficient to address the competition concerns identified during the period covered by this review in the ST market and that it would no longer be appropriate to maintain regulation in this market? If not, please explain why.*

Ofcom has found that market conditions have not fundamentally changed but, on the basis of the sufficiency of *ex post* competition law remedies, no longer proposes to find BT has SMP (and hence remove all of the associated remedies currently imposed on single transit). While not opposed to deregulation in principle, this seems an awkward precedent, which may create unintended complexities. Increased reliance on ex post competition law as opposed to ex ante regulation can be beneficial but such a move needs to be based on more than simply recent pricing trends.

Single Transit (ST) is an important “gatekeeper” product. BT effectively acts as the default interconnect party which is an important position in the market and part of ensuring any to any interconnection. Removing all regulation from the ST market would remove an important safeguard.

A more appropriate approach may be to retain more limited *ex ante* remedies (such as a requirement to provide network access on reasonable request and non-discrimination, but remove some of the other existing SMP obligations). This would represent a more proportionate approach to de-regulation.

Question 7.3: *Do you agree with our assessment that the LTC/LTT market in the United Kingdom has remained competitive since 2009 and that we expect the same competitive conditions to continue during the period of this review? If not, please explain why.*

No comment.

[26] “Wholesale Mobile call termination: guidance on dispute resolution in relation to fair and reasonable charges” Ofcom Statement, published 5 April 2011. Paragraph A1.19 of this guidance refers to a “rate set to reflect the efficient cost of terminating a fixed call in any subsequent fixed call termination market review”, which EE considers would include the pure LRIC fixed termination rates Ofcom proposes setting in this market review process.

Price regulation of termination and origination markets

Question 8.1: *Do you agree that we should cap FTRs at LRIC? Please explain your reasons.*

EE remains of the view that termination rates should be based on a LRIC+ cost measure. Given that mobile termination rates are now set on a pure LRIC basis, EE considers it is important, for reasons of technology neutrality, that fixed termination rates are set using a consistent methodology. See section 4 above.

Question 8.2: *Do you agree that wholesale call origination should be regulated on a LRIC+ basis where the "+" includes a mark-up to off-set the common cost recovery foregone from externally provided wholesale call termination on a LRIC basis? If not, please explain why.*

See section 4 above.

Question 8.3: *Should the FTRs of CPs other than BT be presumed fair and reasonable where they are no higher than the Benchmark FTR? If not, please explain why.*

See answer to consultation question 6.5 above.

Question 8.4: *Should the FTR set by KCOM in the Hull Area be presumed fair and reasonable where it is no higher than the Benchmark FTR? If not, please explain why.*

See answer to consultation question 6.5 above.

Question 8.5: *Do you agree with our proposed approach to the regulation of wholesale call origination rates in the Hull Area? If not, please explain why.*

No comment.

Question 8.6: *Do you agree that LRIC-based FTRs should not be adjusted for APCCs?*

EE agrees that the conveyance charges for onward routing are a separate issue to the question of termination rates. EE notes that this is consistent with the approach taken for analogous charges in the mobile sector.

Cost modelling for call conveyance services

Question 9.1: *Do you agree with our proposed approach to modelling the cost of fixed call origination and fixed call termination? If not, please explain why.*

EE does not have any fundamental concerns with the proposed cost modelling approach which, as described in the Consultation (section 9 and Annex 12 of the Consultation), is broadly consistent with the approach Ofcom has taken in other relevant market reviews.

Many of the relevant assets are used for a range of different products and services, which are price regulated through other market reviews (such as the Business Connectivity Market Review and the Fixed Access Market Reviews). EE therefore considers that it is important that BT is only able to recover its efficiently incurred costs across all of the price regulated products in these various charge controls. Consistent assumptions and some form of cross checks that common assets are being appropriately recovered between market reviews is therefore required. This is extremely hard for stakeholders to assess on the basis of information currently provided in this Consultation and those of other market reviews.

The volume forecasts described in Annex 12 of the Consultation, at the level of detail provided, do not seem unreasonable. As Ofcom will be aware, EE believes that the overall number of lines is increasing and has argued this in the context of the current appeals on the Wholesale Line rental and Local Loop Unbundling charge controls. It is important that Ofcom uses consistent forecasts across this market review and the closely associated Fixed Access Market Reviews. Given the different headline volume metrics for voice and data forecasts (voice being forecast in minutes per line, whereas data is forecast on a peak bandwidth basis), it is not clear to us how the busy hour requirements are being calculated or how the relationship between the voice and data busy hours is being treated. Greater transparency on the way the model treats this issue is required.

EE agrees with Ofcom's base case assumption on market shares, although considers that this is more towards the lower bound. A 25% market share assumption, for the duration of the proposed market review period, would not be credible and could lead to over recovery of costs. EE therefore considers that any lower bound market share assumption should be higher than this.

Interconnection

Question 10.1: *Do you agree with our assessment that BT and KCOM should be required to provide interconnect circuits? If not, please explain why.*

Question 10.2: *Do you agree with the obligations we propose to impose on BT in relation to the provision of interconnect circuits? If not, please explain why.*

Question 10.3: *Do you agree with the obligations we propose to impose on KCOM in relation to the provision of interconnect circuits? If not, please explain why.*

EE has no specific comments in relation to the proposed regulation of interconnect circuits.

Charge control specification

Question 11.1: *Do you agree with our proposed glide paths? If not, please explain why.*

See section 4 above in relation to the proposed glide paths in general. EE agrees that fixed termination rates should be aligned with pure LRIC benchmarks as soon as possible, given that mobile termination rates have already reached this cost benchmark. This is consistent with the arguments which BT made in the recent appeals in relation to mobile call termination.

EE does not agree with the proposed RPI cap for the NTS call origination condition for the reasons set out in section 3. EE argues that the cap should be stricter and set using an RPI-RPI formula.

Question 11.2: *Do you agree with our proposal to allow a six week implementation period for Fixed Termination Rates to be capped at LRIC? If not please explain why.*

EE notes that mobile operators have been given much shorter implementation periods in the past (for example, when the rates were changed in October 2011) and does not consider that there are any circumstances which warrant different treatment for the fixed sector.

Question 11.3: *Do you agree with our proposals relating to "Charge control design"? If not, please explain why.*

The detailed design of the charge control largely carries over existing arrangements and is also consistent across other charge controls set by Ofcom. There is value in such consistency and regulatory certainty. Absent good reasons for change, EE therefore agrees with the proposals in the Consultation on issues such as the rounding to be applied and how traffic weights are applied to assess compliance with the price caps.

We also agree with the continuing use of the All Items RPI as the inflation index by which charge controls are specified. There are good reasons for the continuing use of this index. Not least this is a well understood index with a long history and its continuing use ensures stability and regulatory certainty. This index is also widely used by other economic regulators. Any change to the inflation index used to set charge controls has wider ramifications which should be considered carefully and would also need to involve consideration of the interaction with other charge controls in the electronic communications sector (both from a competition and an efficiency perspective). Given that the impact of such a change would potentially be wider than a single market review, Ofcom should not make any such change solely in the context of a single market review but would need to consult on the impact on all future market reviews.

The one area where EE considers there is a justification for change, to ensure consistency with mobile termination rate charge controls, relates to the continuing use of a basket style charge control to allow different time of day rates: see section 4 above for EE's comments on this issue.