2nd April 2013

Telappliant's response to Ofcom's consultation on its review of the fixed narrowband services market

Telappliant Ltd does not object in principle to the introduction of FTRs based on pure LRIC. However, this adjustment is likely to have a serious negative effect on our business and we do not believe that an implementation date of October 2013 will allow us sufficient time to adjust to the new regime and renegotiate our supplier and customer contracts.

An 80% reduction in termination rates (from 0.204ppm currently to 0.04ppm in October) will have a significant impact on our number hosting arrangements, where we offer our termination revenues in lieu of hosting charges. These contracts will have to be renegotiated with our hosting partners.

We regard termination revenues as “cost neutral” rather than profit generating, in that they cover the cost of the infrastructure to terminate the calls and contribute to the running cost of our network. We currently offer free VoIP termination to our customers and we will no longer be able to do so when the new termination rates are introduced.

We firmly believe that Ofcom should delay the introduction of these new pure LRIC-based termination rates until October 2014, which is likely to coincide with the introduction of the new NTS regime.

The European Commission first published its Recommendation on termination rates (2009/396/EC) in May 2009. Ofcom’s last review of the narrowband market was completed in September 2009 and at that time Ofcom chose not to adopt the Commission’s “pure LRIC”. Ofcom’s decision, some four months after the EC issued its 2009 Recommendation, was to set FTRs with an allowance for common costs. It is unfortunate that the latest market review consultation comes after the Commission’s December 2012 deadline for introducing this cost model, therefore leaving insufficient time for industry to adjust.

We do not accept any suggestion by Ofcom that these changes have been “trailed” and that the industry should have been expecting them. This is the first time Ofcom has formally consulted on its proposals, and the first time that specific dates and numbers have been proposed. We do not believe that Telappliant and other operators should be penalised for Ofcom’s delay in implementing the Commission’s proposals.

Paragraph 12 of the 2009 Recommendation permits NRAs in certain circumstances to set interim prices based on an approach other than the bottom-up LRIC model until 1 July 2014. We appreciate that this provision is intended to apply mainly to NRAs with “limited resources”. We note, however, that this Recommendation is not strictly mandatory, but that “utmost account” must be taken of its contents. We also note that Ofcom’s 2011 decision on mobile call termination rates imposed a four year glide path until 2014 (subsequently revised to 2013 by the CAT), despite the Commission’s request that MTRs be at pure LRIC by 31 December 2012.

Telappliant Ltd, Layden House, 76 -86 Turnmill St London, EC1M 5QU

tel: 0845 004 4040
fax: 0845 004 4041
email: info@telappliant.com
web: www.telappliant.com

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Whilst we appreciate the fact that the Competition Commission and the Competition Appeals Tribunal have reduced the period of the MTR adjustment until 1 April 2013, we think that FTRs are distinguishable because the "harm" being suffered by consumers is not as pronounced as the harm caused by the very high MTRs and the relative benefits will not be as great - Ofcom states in section 11 of the consultation document that it expects the impact on retail customers of fixed line operators to be minimal.

In the UK's particular case, any benefit to consumers from introducing the FTR reduction quickly is offset by the harm caused by two disruptive changes being introduced, rather than a single change when the NTS changes take effect.

Whilst some operators may be able to benefit from the planned increase in wholesale call origination charges, VoIP players such as ourselves will be disproportionately affected and will suffer a large drop in profits.

Ofcom has suggested that the drop in profits arising from the termination rate reduction is mitigated by the "two-sided" nature of the call termination market. The loss resulting from the call termination rate reduction can, Ofcom suggests, be compensated for by price increases on the other side of the market (subscription and/or usage) via a "waterbed effect". Whilst this may apply in the case of mobile network operators, it does not apply to the VoIP market as we operate a termination-only service. For our business, there is no direct consumer relationship linking termination and origination charges and no possibility of mitigating the effect of this adjustment. In any event, the drop in FTRs is far greater than the (transitory) increase in call origination charges.

Ofcom's proposals for a rapid adjustment will disproportionately affect the VoIP industry. By decreasing the competitiveness of VoIP companies, Ofcom could be introducing a significant market distortion. Fixed telephony providers are not able to rebalance their tariffs in the same way that mobile network operators can.

Introducing these changes in October 2013 would be both disruptive and unjustified. Ofcom must allow sufficient time for operators and customers to adjust to new levels and structures of termination rate charges and to take these charges into account in their business plans and planned capital expenditure.

Regards,

The Telappliant Board

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email: info@telappliant.com
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