EUROPEAN COMMISSION

Brussels,
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Office of Communications
(OFCOM)

Riverside House - 2a Southwark
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United Kingdom

For the attention of:
Mr Ed Richards
Chief Executive Officer

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Dear Mr Richards,

Subject: Commission Decision concerning Case UK/2013/1495: Call origination on the public telephone network provided at a fixed location in the UK

Commission Decision concerning Case UK/2013/1496: Call termination on individual public telephone networks provided at a fixed location in the UK.

Comments pursuant to Article 7(3) of Directive 2002/21/EC

I. PROCEDURE

On 20 August 2013, the Commission registered a notification from the United Kingdom national regulatory authority, the Office of Communications (OFCOM)[1], concerning the markets for call origination on the public telephone network provided at a fixed location and call termination on individual public telephone networks provided at a fixed location[2] in the UK.

The first national consultation[3] ran from 17 May 2012 to 28 June 2012. The second national consultation ran from 28 September 2012 to 9 November 2012. The third

1 Under Article 7 of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ L 108, 24.4.2002, p. 33, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37, and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12.

2 Corresponding to markets 2 and 3 in Commission Recommendation 2007/879/EC of 17 December 2007 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 (Recommendation on Relevant Markets), OJ L 344, 28.12.2007, p. 65.

3 In accordance with Article 6 of the Framework Directive.

national consultation ran from 5 February 2013 to 2 April 2013.

On 30 August 2013, a request for information[4] was sent to OFCOM and a response was received on 4 September 2013.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities (NRAs), the Body of European Regulators for Electronic Communications (BEREC) and the Commission may make comments on notified draft measures to the NRA concerned.

II. DESCRIPTION OF THE DRAFT MEASURE

II.1. Background

The fixed narrowband services markets in the UK were previously notified to and assessed by the Commission under case UK/2009/0898[5]. These markets covered the supply of wholesale exchange lines, fixed call origination, fixed call termination and various conveyances and transit services. It also included interconnection circuits and BT's product management, policy and planning activities (PPP).

Concerning wholesale fixed narrowband exchange lines, OFCOM proposed three separate markets[6] not included in the Recommendation on Relevant Markets. Regarding call origination, OFCOM proposed a market definition that was different from the Recommendation's market 2, in that it defined local tandem conveyance/ transit as a separate market.[7] In both markets OFCOM proposed two separate geographic markets: (i) the UK excluding the Hull area; and (ii) the Hull area. BT had SMP in the markets for wholesale exchange lines and for wholesale call origination in the UK excluding the Hull area. As for the Hull area, KCOM had SMP in both markets.

OFCOM applied a full set of remedies to the exchange lines markets, call origination, interconnection circuits and BT's product management, policy and planning activities, including charge controls[8] and requirements to provide WLR[9] as well as CPS and CS.

As for call termination services, OFCOM's proposed market definition differed from the Recommendation's market 3, since it also defined local-tandem conveyance/ transit as a separate market, while at the same time limiting the market to termination of geographic calls[10]. OFCOM found that each network had SMP in the market for fixed geographic call termination on its own network.

OFCOM applied a full set of remedies to BT and KCOM in the wholesale call termination market, including charge controls for BT on the basis of a LRIC plus

[4] In accordance with Article 5(2) of the Framework Directive.

[5] C(2009)4441.

[6] They were: (i) wholesale analogue exchange line services; (ii) wholesale ISDN2 exchange line services; (iii) wholesale ISDN30 exchange line services.

[7] The three criteria test was met for this market.

[8] Charge controls applied to the following markets: wholesale analogue exchange line services, call origination, call termination, the NTS uplift charge, interconnection circuits and PPP. OFCOM proposed to regulate charges using the RPI -/+X method.

[9] A new core WLR service available to both residential and business customers was proposed later on (cf. UK/2009/0944). The Commission made no comments.

[10] The three criteria test was met for this market. OFCOM also proposed to define the markets for local-tandem conveyance and transit (LCT/LTT) and for wholesale transit services, but these markets did not pass the three criteria test.

methodology with a mark-up for common costs and for cost of capital recovery and a requirement to notify charges, terms and conditions.[11] For other CPs, OFCOM imposed the requirement to provide call termination on fair and reasonable terms.

The Commission issued a comments letter, recommending that OFCOM applied a pure LRIC costing methodology as recommended in the Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU[12].

II.2. Market definition

1) Market for wholesale call origination

In the current draft measures, OFCOM proposes to define a product market that includes all wholesale call origination (including that used to supply retail CPs targeting the residential and the business segment, as well as voice-only and dual-play customers). OFCOM continues to identify two relevant geographic areas: 1) the UK excluding the Hull area; and 2) the Hull area. OFCOM considers that the characteristics of these two geographic areas are sufficiently different to consider them separately as the competitive conditions vary significantly between them.

2) Market for wholesale call termination

In relation to market 3, OFCOM proposes to define the product market as termination services[13] that are provided by one CP to another for the termination of voice calls to UK geographic numbers allocated by OFCOM to that CP pursuant to the UK numbering plan[14]. Relying as the reference point on the number range controlled by a CP and for which the CP is able to set fixed termination rates (FTRs) is a change from the previous market review, where the relevant market was defined by reference to individual fixed networks.

OFCOM considers that the role of the allocated number range is a critical element in the individual network used to provide wholesale call termination, both fixed and mobile. OFCOM also considers that the underlying control of the wholesale call termination ultimately rests on control of the number allocation, since hosted numbers can be moved between different hosting networks or, ultimately, a number range holder may move the numbers onto its own network. Finally, OFCOM further adds that this approach provides greater technological neutrality and it aligns the mobile and fixed termination market definitions in the UK, thus bringing coherency and regulatory certainty to the UK's industry. The geographic extent of each market is defined as the area served by that CP within the United Kingdom.

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[11] OFCOM later proposed to apply an additional obligation of transparency – publication of tariffs - to all CPs, instead of just BT and KCOM. The Commission invited OFCOM to impose an adequate ex ante price control and a non-discrimination obligation on all communication providers regarding their fixed termination rates (see UK/2009/0974).

[12] Commission Recommendation of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC) ("Termination Rates Recommendation").

[13] Termination services, in this definition, are considered to be the conveyance of all signals (including relevant control signals) required to terminate calls on a customer's exchange line from the point in the network closest to the end customer's point of connection to the network where those signals can be accessed by another CP.

[14] This market definition does not include non-geographic numbers, which OFCOM considers to be a distinctive service subject to different competitive constraints. A separate review of non-geographic services is currently undergoing.

II.3. Finding of significant market power

1) Market for wholesale call origination

OFCOM proposes to designate BT as having SMP in the UK excluding the Hull area. BT still has around 62% market share on fixed narrowband networks[15]. Furthermore, in the absence of regulation, OFCOM considers that BT would not face a sufficiently strong constraint on the price of wholesale call origination. OFCOM further considers that although there is a range of potential direct and indirect constraints on BT from both inside and outside the defined market, such constraints are unlikely to constrain sufficiently BT's SMP during this review period. In the Hull area, OFCOM identifies KCOM as having SMP with a 100% market share of wholesale call origination.[16]

2) Market for wholesale call termination[17]

OFCOM indicates that each number range holder has, by definition, 100% of the market for calls terminating to its numbers, thereby raising a presumption that it has SMP. Furthermore, barriers to entry are high and there is not sufficient countervailing buyer power to act as a constraint to each operator.

II.4. Regulatory remedies

1) Market for wholesale call origination

OFCOM proposes to impose a full set of remedies on BT for the UK territory excluding Hull, including a requirement to provide network access on reasonable request; a requirement not to discriminate unduly; transparency obligations[18]; and a charge control based on a LRIC+ methodology.[19]

OFCOM also proposes to impose a full set of remedies on KCOM for the Hull territory[20].

The cap for wholesale call origination should be linked to that of wholesale call termination, with the mentioned adjustment to these rates right from the beginning of the charge control, so that they can be brought in line with the new LRIC+ rates. This will

15 The market share figures, however, show a decline of ca. 11% points from around 73% in 2009.

16 In OFCOM's view, alternative operators do not create a constraint on KCOM and barriers to entry are high due to significant sunk costs in a relatively small market. OFCOM also doesn't consider that mobile or VoIP act as a significant constraint on fixed services at this stage.

17 OFCOM further proposes to remove all remaining ex ante regulation in the relevant markets at retail level for fixed voice retail markets in the Hull area since ex post competition law is considered sufficient. Regarding single transit, OFCOM considers that ex post competition law is sufficient to address any competition concerns. All the previously analysed retail markets remain competitive.

18 The proposed transparency obligations include *inter alia* transparency as to quality of service, an obligation to publish a reference offer and an obligation to notify new charges 56 days in advance. The latter constitutes a change from previous practice, which required the SMP operator to adhere to a 90 days notification period.

19 According to OFCOM, the design of the charge control allows common costs to be taken into account, as well as BT to retain any increased profits should it be able to reduce its costs below the level expected when the cap was set. OFCOM proposes it to be regulated on the basis of LRIC+. The “plus” includes an additional contribution to common costs no longer recovered from FTRs at LRIC and administration costs no longer separately recovered through a PPP charge.

20 OFCOM indicates that it considers that KCOM’s SMP can be reasonably addressed through a network access requirement, provided on fair and reasonable terms. Implementing a charge control, as it did to BT, is considered by OFCOM not to be justifiable or proportionate given the small size of the market. Rates would be presumed fair and reasonable where they are no higher than the wholesale call origination rate determined by the charge control on BT, unless a higher rate can be justified by objective cost differences.

happen as from 1 January 2014. In the period between 1 October 2013 and 31 December 2013, OFCOM indicates that the rate for each service in the call origination basket shouldn't be higher than the rate from 30 September 2013. Call origination rates are expected to increase from 0.245 pence (for the 2012/2013 period) to 0.400 pence in the (2013/2014 period), which represents an increase of 65.4%, before decreasing to 0.386 pence in the 2014/2015 period.

2) Market for wholesale call termination

OFCOM proposes to impose a full set of remedies on BT, including a charge control[21]. With regards to termination rates OFCOM proposes that BT's FTRs should be calculated on the basis of a pure LRIC methodology in compliance with the Commission's 2009 Termination Rates Recommendation.

For all other CPs with SMP (including KCOM[22]), OFCOM proposes to impose the following remedies in the provision of wholesale call termination services: (i) requirement to provide network access on reasonable request, including fair and reasonable terms, conditions and charges with guidance; (ii) requirement to notify charges.

Concerning FTR regulation, OFCOM indicates that non-BT CPs are obliged to provide termination services on fair and reasonable terms and conditions until September 2016. While no traditional price control is implemented for non-BT CPs, the obligations include the requirement to offer termination services on fair and reasonable charges. In this respect OFCOM proposes to continue with the industry guidance on its interpretation of "fair and reasonable", first published in April 2011, meaning that any FTRs above the benchmark FTR (i.e. the charge controlled rate based on BT's pure LRIC-based FTR) will be presumed by OFCOM to be not fair and reasonable[23]. This system is aimed to lead to a *de facto* symmetry for the FTRs of all SMP operators. OFCOM confirmed that since publication of its guidelines, it has not registered any disputes concerning the level or symmetry of FTRs.

OFCOM justifies the difference in remedies with the need to treat BT differently from other CPs in light of its greater potential to create competitive distortions as compared to other CPs. Furthermore, OFCOM clarifies that the regulatory practice for non-BT fixed termination services has been to: (i) set a regulated price for the incumbent SMP operator; (ii) set an SMP condition on each other operator to ensure termination rates are fair and reasonable, in light of the 171 smaller providers of wholesale call termination in the UK; and (iii) provide industry guidance on interpreting fair and reasonable. OFCOM further points out that this approach has led to symmetrical FTRs in the UK and that the proposed approach is more proportional (i.e. less intrusive but equally effective) when compared to imposing a charge control on each of the 171 SMP operators individually[24].

[21] OFCOM's preferred method of charge control regulation is the following: RPI +/-X, which it considers creates incentives on the incumbent to increase its efficiency.

[22] The additional regulation on KCOM is proposed to be removed. Concerning the setting of FTRs, the guidance set for the interpretation of fair and reasonable network access will now apply to FTR regulation in the Hull area (see footnote 17).

[23] If a non-BT CP wishes to rebut this strong presumption by OFCOM it would need to present properly reasoned justification for any FTRs above the benchmark by reference to a three-stage test that OFCOM sets out in its "fair and reasonable" guidelines.

[24] In addition, OFCOM considers it unlikely that non-BT CPs ability to favour their own vertically integrated retail businesses can create substantial competitive distortions.

Fixed Termination Rates are expected to decrease from 0.219 (for the 2012/2013 period) to 0.034 in the (2013/2014 period), which represents a decrease of 87.3%. If adopted, FTRs in the UK would be among if not the lowest in the EU.

OFCOM indicates that FTRs at pure LRIC will be set at the earliest possibility, i.e. as from 1 January 2014. This date is justified predominantly by (i) the need to take into account a 56 days' notice period to communicate the changes of rates; (ii) the larger than initially foreseen reduction in FTRs which is likely to require BT to undertake further internal governance; (iii) the need to have billing cycles starting from the beginning of a month[25]; (iv) the need for other CPs to link their FTRs to those of BT[26]; and (v) the need for some CPs[27] to change their business models.

In the period between 1 October 2013 and 31 December 2013, OFCOM indicates that the rate for each service shouldn't be higher than the rate from 30 September 2013.

Interconnect circuits[28]

OFCOM proposes to impose obligations concerning interconnect circuits, as an ancillary remedy based on the SMP assessments made for the markets for wholesale call origination and call termination, since the provision of interconnect circuits is closely related to the provision of services in these markets. Therefore, OFCOM proposes the imposition of a full set of remedies for interconnect circuits to BT and KCOM.

III. COMMENTS

The Commission has examined the notification and the additional information provided by OFCOM and has the following comments:[29]

Entry into force of pure LRIC Fixed Termination Rates

The Commission welcomes OFCOM's methodological change towards calculating FTRs based on a pure LRIC methodology in line with the Commission's 2009 Termination Rates Recommendation and the resulting substantial decrease in the level of FTRs.

The Commission notes that pure BU-LRIC FTRs are scheduled to enter into force on 1 January 2014. The Commission would like to remind OFCOM that pursuant to the Termination Rates Recommendation NRAs should ensure that termination rates are implemented at a cost-efficient (pure BU-LRIC) level by 31 December 2012.

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25 Given the fact that OFCOM now anticipates the adoption of the final measure not before the end of September at the earliest, i.e. later than originally foreseen, it will be difficult – in light of the practical considerations set out above – for CPs to put all necessary changes in place for new FTRs to be used for the billing cycle of 1 December. As a result, the next possible date is the 1 January 2014.

26 Each of the 171 CPs will have to consider setting their rates based on those notified by BT and adapt its internal billing systems accordingly.

27 This is notably the case of CPs focused on inbound call management services, who initially requested a period of at least one year for the implementation of LRIC-based FTRs

28 Interconnect circuits provide the physical infrastructure to connect the exchanges (switches) of two CPs in order to allow traffic to pass between them. All CPs have obligations related to interconnection under the UKs General Conditions of Entitlement.

29 In accordance with Article 7(3) of the Framework Directive.

The Commission takes note of the practical obstacles set out by OFCOM, which, according to OFCOM, require the entry into force of the new and lower FTRs not before 1 January 2014. The Commission takes particular note of the specific regulatory requirement to notify new rates 56 days in advance to other CPs and to OFCOM. Furthermore, the Commission recognises that the substantial difference between the FTRs proposed by OFCOM in the national consultation and the much lower FTRs notified to the Commission in the draft measure may require additional time before the new rates can be actually applied. Against the background of the one year implementation delay compared to the implementation date set out in the Termination Rates Recommendation, the Commission invites OFCOM to further re-assess whether the timeline for entry into force of the new rates can be shortened and to include such assessment in the final measure, fully setting out the reasons in case the date of 1 January 2014 is kept nevertheless.

Need to impose ex ante price control obligation

The Commission notes that OFCOM proposes not to impose a non-discrimination obligation nor an ex ante price control on non-BT CPs, although in 2009[30], the Commission had requested OFCOM to do so vis-à-vis all CPs.

The Commission acknowledges the arguments put forward by OFCOM for its approach, in particular the fact that this approach over the past 10 years has led to symmetric FTRs today. The Commission takes particular note of the fact that the system implemented by OFCOM has already created a *de facto* symmetry, based on OFCOM's clear statement, expressed in its industry guidance, that it would presume FTRs above the pure-LRIC level calculated for BT, not to be fair and reasonable and as demonstrated by the lack of disputes concerning the level or symmetry of FTRs in recent years.

The Commission stresses that, in view of the smaller size of (certain) CPs, cost orientation of termination rates can also be ensured by mandating reciprocal, symmetric rates resulting from one cost-model for all CPs based on a hypothetical efficient operator, which could equally result in symmetric termination rates that serve to promote efficiency, competition and maximise consumer benefits.

Moreover, the Commission also emphasises that dispute resolution procedures, as envisaged by OFCOM, may not be sufficient to remedy a potential market failure in a timely, efficient and transparent way. Such a measure could remedy the situation only once OFCOM has learned of a possibly abusive pricing behaviour, and in any case it would be binding only for the undertakings in litigation. By the time OFCOM has assessed the situation and taken appropriate regulatory measures, customers would already have suffered a loss in the form of higher off-net retail call charges.

[30] See UK/2009/0974.

As a consequence, the Commission urges OFCOM to consider imposing an ex ante price control on all CPs, which is based on the costs of a hypothetical efficient operator. In particular, OFCOM is called upon to implement cost orientation in an efficient manner, by way of a measure which does not impose an undue procedural burden on alternative communication providers, but sets efficient cost-based termination rates for all operators to the benefit of competition and, ultimately, consumers. In the event that OFCOM refrained from imposing the recommended ex ante price control on all CPs, the Commission asks OFCOM that it should set out in its final measure in further detail its reasons for not doing so. In addition the Commission urges OFCOM to monitor the termination markets continuously and to intervene without delay by way of the measures recommended by the Commission above, should disputes over FTRs arise.

Pursuant to Article 7(7) of the Framework Directive, OFCOM shall take the utmost account of the comments of other NRAs, BEREC and the Commission and may adopt the resulting draft measure; where it does so, shall communicate it to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take *vis-à-vis* other notified draft measures.

Pursuant to Point 15 of Recommendation 2008/850/EC[31] the Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission[32] within three working days following receipt whether you consider that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication.[33] You should give reasons for any such request.

Yours sincerely,

For the Commission,
Robert Madelin
Director-General

31 Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, OJ L 301, 12.11.2008, p. 23.

32 Your request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32 2 298 87 82.

33 The Commission may inform the public of the result of its assessment before the end of this three-day period.