Paul Jacobus
4th Floor, Competition Group
Ofcom
Riverside House
2A Southwark Bridge Road
London
SE1 9HA

9 November 2012

Dear Paul,

Narrowband Market Review: consultation on possible approaches to cost modelling for the Network Charge Control for the period 2013-2016 (the Consultation)

A robust and consistent cost modelling methodology is clearly central to ensuring that charge controls achieve Ofcom's regulatory objectives. EE is therefore pleased to provide this response to the Consultation on this important topic. EE considers that it is important that there is regulatory consistency across different relevant markets, which consistently promotes dynamic efficiency and ensures investment incentives across the electronic communications sector are not distorted. Mobile termination rates are currently regulated on the basis of "pure" Long Run Incremental Cost (LRIC). As Ofcom is aware EE does not consider that this is the right cost benchmark, but if this continues to be benchmark used then a consistent approach with fixed termination rates is important. In this context, EE supports the development of an appropriate cost model to calculate the level of fixed LRIC in a consistent way.

In doing so, however, it will also be important to ensure that regulated charges across different market reviews only allow the recovery of the efficient level of costs. Telecoms networks have large amounts of fixed and common costs. An important point of principle, not addressed in the current Consultation, is therefore ensuring that common costs are appropriately recovered (and not over-recovered) across different relevant markets. BT is subject to a range of other charge controls which will not be based on the cost model proposed in the Consultation. Ofcom will need to ensure that costs which are common between different regulated products and services, which are regulated using fundamentally different costing approaches, are appropriately allocated. EE urges Ofcom to take this issue into account both in relation to its current project considering the regulatory financial reporting

1 Trident Place
Hatfield Business Park
Hatfield
Hertfordshire
AL10 9BW

t: +44 1707 315000

ee.co.uk

requirements on BT as well as in subsequent consultations on the Fixed Narrowband Market Review.

EE expects to provide further input into subsequent consultations on this market review and will be happy to attend and provide input in any subsequent discussions about the development of the cost model proposed in the Consultation. At this stage, EE has the following specific comments on the approach laid out in the Consultation.

- The Consultation proposes that Next Generation Networks (NGNs) be considered the modern equivalent asset (MEA) for call origination and termination services. Any application of the MEA approach also needs to take account of efficiency considerations. EE would therefore agree that NGN is the appropriate MEA to the extent that it does not mean any increase in the level of costs from current levels. This would be consistent with the approach taken by the Competition Commission (CC) in the 2008 appeal on Mobile Call Termination, where the CC stated that "the introduction of a new and more efficient technology should not lead to an increase in price for an existing service".[1]
- Further, the level and recovery of any TDM-IP conversion costs will need to ensure that regulated entities are not able to over-recover such costs. Where traffic is passed between two networks using both protocols there will also need to be a robust approach which ensures no over-charging and that the costs of any conversion are borne by the entity which can most efficiently undertake it. The Consultation suggests that these issues will be considered in more detail in the forthcoming January consultation (paragraph 3.82). The detail of the approach is likely to be important here, to ensure that charges remain cost based overall. If NGN IP based interconnect is taken as the benchmark then the structure of any conversion costs (which are essentially the cost of different types of ports between the networks)

1 Trident Place
Hatfield Business Park
Hatfield
Hertfordshire
AL10 9BW

t: +44 1707 315000

ee.co.uk

1 See paragraph 2.9.10 of CC's Final determination "Mobile phone wholesale voice termination charges" in cases 1083/3/3/07 and 1085/3/3/07 dated 16 January 2009. This led the CC to conclude in that case that there should be a "2G cap" on 3G termination rates such that a newer technology did not lead to higher prices than the older less efficient technology.

will need to be properly taken into account in deriving suitable charges. These charges will be unavoidable in the short to medium term and need to be regulated.

- No additional cost should be recovered where the terminating party is not able to offer IP interconnection. EE considers that it will be crucial to ensure that there are the right investment and migration incentives in place, with originating operators able to benefit from the efficiency gains of progressive migration as well as a need to take account of the fact that these ports are generally used for traffic in both directions. Where BT is terminating traffic it would be contrary to the EC recommendation on call termination for all of these costs to then be recovered solely from that terminating traffic.
- In paragraph 4.17, one of the principles which Ofcom proposes to apply to the new cost model is "no retrospection". The Consultation therefore suggests that the path of NGN unit costs should not assume historic periods were able to recover costs not allowed under previous cost models used by the regulator. This approach is not consistent with the assumptions made in the last Mobile Call Termination market review and EE requests that Ofcom explain why a different approach is necessary and justified between these separate relevant markets.
- Figures 3 and 4 of the Consultation provide a high level overview of the voice traffic and data traffic volume assumptions which Ofcom proposes to use. At a high level, the voice usage per line assumption seems reasonable. EE would also agree with an increase in the peak data usage per line over time. The shape of the curve in Figure 4 suggests that the rate of increase relatively sharply increases in 2019. EE questions what underlies this assumption which does not seem to be supported. In considering these volume assumptions, EE also questions why voice usage is being expressed in volume per line terms whereas data usage is being assessed on a peak basis. In a cost model of this type it will be important for there to be clarity around exactly what is driving cost (which has generally been considered to be peak usage in previous such models) and the relationship between voice and data as a result. Ensuring that this aspect is clear, transparent and consistent will also be important in ensuring that there is a reasonable approach to common costs across different market reviews as discussed above.
- Finally, the Consultation proposes a number of different possible scenarios concerning the market shares of the efficient operator. The exact use to which the proposed cost model is put will be important in this context. At this stage, EE simply notes that it will be vital to ensure that the scenario used to set charge controls takes into account both the call termination revenue which BT receives from customers served through Wholesale Line Rental and the revenue it

1 Trident Place
Hatfield Business Park
Hatfield
Hertfordshire
AL10 9BW

t: +44 1707 315000

ee.co.uk

receives directly for calls to its own retail customers. Further, it is not clear how these assumptions on market share scenarios will impact on charges levied by other fixed providers of call termination (which are currently based on the principle of reciprocity as Ofcom has interpreted it in its most recent guidance on "fair and reasonable" criteria for fixed termination rates[2]). EE expects that these issues on the use of the cost model will be addressed in the January consultation.

Yours Sincerely,

Robyn Durie
Regulatory Director
mobile 07940514639
e-mail robyn.durie@ee.co.uk

1 Trident Place
Hatfield Business Park
Hatfield
Hertfordshire
AL10 9BW

t: +44 1707 315000

ee.co.uk

2 "Fair and reasonable charges for fixed geographic call termination, Statement and Final Guidance", published 27 April 2011