Three’s Response to Ofcom’s Second Consultation on Simplifying Non-geographic Numbers

Non-confidential

2 July 2012

Three.co.uk

1. Summary of Three's response

1 Hutchison 3G UK Limited ("Three") welcomes the opportunity to respond to Ofcom's second consultation on Simplifying Non-Geographic Numbers dated 4 April 2012 **(the "2012 Consultation")**.

2 By way of general comment, Three welcomes Ofcom's concerted efforts to deal with the issues of consumer harm identified in the Consultation. As will be seen from this response, Three supports the majority of Ofcom's proposals for reform, including Ofcom's tariff unbundling proposal for non-geographic ("NG") revenue-sharing number ranges.

3 Three however has certain concerns regarding other aspects of Ofcom's proposals. First, Ofcom's Freephone remedy proposes to introduce retail reform in the absence of any significant market power ("SMP") finding. Three's predominant concern in the context of this response is that Ofcom have not defined the limited and exceptional circumstances in which they consider they have the power to regulate retail price absent a finding of SMP. Second, there are significant risks to the successful implementation of Ofcom's proposed approach regarding wholesale origination charges. Both of these concerns will be explained in more detail in this response.

4 Finally, Three is of the view that existing issues regarding wholesale charges are likely to remain irrespective of the sustained efforts that Ofcom have made to remedy problems at the retail market level. Ofcom's review has focused on retail transparency, but there are, and will remain, issues affecting the wholesale level of the market. These should be examined fully in a market review.

Ofcom's tariff unbundling proposal

5 Three supports Ofcom's proposal to apply tariff unbundling to revenue sharing number ranges, i.e. to split retail price into an Access Charge ("AC") and a Service Charge ("SC"). We agree that this remedy, if implemented consistently across all revenue-sharing number ranges, should address concerns at the retail level by improving price transparency and increasing competition between service providers ("SPs") on the one hand and originating communication providers ("OCPs") on the other.

6 We agree that bespoke SCs should not be allowed and SCs should be capped for each number range. This is of critical importance in order to reduce the likelihood of disputes at the wholesale level. In addition, given that OCPs will need to pass through SCs to customers, it is important that a centralised SC database is maintained accurately and kept up-to-date. All changes to SCs should take place on predetermined dates (e.g. 1st of

each month) and should be communicated to OCPs at least 30 days in advance. Three considers that this database should be maintained by a public sector body (preferably Ofcom).

Ofcom's proposals for the Freephone and 116 ranges

7 Three notes that Ofcom's preferred option in the 2012 Consultation is that calls to 080 and 116 ranges should become free to a caller[1] - a proposal which entails:

1) A maximum retail price of zero for the origination of calls to those number ranges from all telephones, both fixed and mobile ("zero rating"); and

2) The imposition of an access condition on all terminating communications providers ("TCPs") requiring that they purchase wholesale origination services for calls terminating on designated free to caller ranges from any requesting OCP on fair and reasonable terms, and notify their SP customers of any initial revision to the charges for wholesale origination services within two months of Ofcom imposing the requirement for zero maximum prices.

8 Three fully supports the rationale of consumer benefit behind Ofcom's zero rating proposal for 080 and 116 number ranges. Ofcom have taken the view that zero rating would provide the greatest benefits to consumers, providing a simple and consistent price point for consumers to remember. Three has previously endorsed the view that a significant number of price points means that it is difficult for consumers to be adequately informed about the price of calls to non-geographic numbers and has consistently supported some degree of regulatory intervention to promote price awareness of consumers.[2] Resolving identified issues of consumer price awareness is an aim which Three wholeheartedly supports. To that extent, Three welcomes Ofcom's proposal to zero rate calls to 080 and 116 numbers. However, our support is subject to a number of concerns regarding Ofcom's suggested approach to implementing its policy decision.

[1] 2012 Consultation [16.258].
[2] Three response to Ofcom's first consultation on simplifying non-geographic numbers , 31 March 2011 ("Three's 2011 response") at [4] –[5].

(i) Retail price regulation without a finding of SMP

9 First, Ofcom intend to impose retail price control on OCPs in the absence of a finding of SMP.[3] In implementing the proposals we understand Ofcom would intend to use their power under s.58(1)(aa) Communications Act 2003 ("CA"). Three has the following comments:

(1) As Ofcom recognise, s.58(1)(aa) has to be interpreted consistently with the overall approach to price regulation in the CRF and the provisions of Annex C of the Authorisation Directive (as amended).[4] Three raised a concern in its response to Ofcom's 2010 Consultation[5] that the term "rights of use" in Annex C of the Authorisation Directive cannot properly be understood to cover the activities of an OCP in conveying a call to a non-geographic number ("the narrow interpretation") and accordingly the power in that Annex to set tariff principles and maximum prices for the purposes of ensuring consumer protection cannot be used as the basis for regulating the retail price of OCPs. Three notes the reasons Ofcom gives in the 2012 Consultation for rejecting the narrow interpretation of "rights of use" but maintains its concerns.

(2) Given Three's support for Ofcom's proposal to zero rate, Three's predominant concern in relation to this issue is that Ofcom avoid using their proper powers in a way which contradicts the general approach to price regulation in the CRF, particularly in light of the uncertainty[6] over the extent of Ofcom's power in s.58(1)(aa). If Ofcom consider they do have the power to regulate retail price in the absence of SMP for the purpose of ensuring consumer protection, it is vital they define the limited and exceptional circumstances in which they say such a power could be exercised. Three is concerned that Ofcom's interpretation of their legal powers risks eroding the fundamental principle that price regulation is a measure of last resort, contingent upon a finding of SMP. Three's response in this regard is set out in detail in the response to Question 16.1 below.

[3] This concern is not only limited to Ofcom's proposals for Freephone and 116 number ranges, but relates also to the tariff unbundling proposal, as part of which Ofcom have considered a proposal to regulate the Access Charge.
[4] Directive 2002/20/EC as amended by Directive 2009/140/EC.
[5] Three's 2011 response at [68]-[67] and [78].
[6] For the avoidance of doubt, Three remains of the view that the interpretation of "rights of use" adopted in Three's 2011 response is correct. Uncertainty in the extent of Ofcom's powers results from the fact that Ofcom have taken the view that they have the power to regulate retail price in the absence of SMP, despite a number of operators contending that that is not the case.

(ii) The Access Condition and the need to ensure recovery of efficient costs of origination

10 Second, Ofcom's preference for zero rating is founded on the assumption of a set of circumstances at the wholesale level of the market, under which OCPs will receive an origination payment which will be sufficient to meet their efficient costs of origination. It is a well established principle of fairness that OCPs should recover their costs of origination.[7] Three is concerned that Ofcom's proposal for the implementation of zero rating does not do enough to guarantee that OCPs will in fact be able to recover their efficient costs of origination, at least without regular recourse to Ofcom's dispute resolution procedure:

(1) Under Ofcom's proposals, OCPs will have to negotiate a payment for the origination service they provide with TCPs which have a recognised monopoly.[8] Further imbalances in negotiating strength in this market lie in the terms of BT's Standard Interconnect Agreement ("SIA") and BT's power by reason of its vertical integration.

(2) Ofcom's guidance to the proposed access condition would therefore need to be sufficiently robust to ensure that MNOs can successfully recover their efficient costs of origination in the context of a wholesale market in which Ofcom recognises there are imbalances of negotiating power.

(3) Three remains unconvinced as to what substantive difference Ofcom's proposed access condition would make to the position as it would be absent ex ante regulation, unless the accompanying guidance as to the meaning of "fair and reasonable terms and conditions (including charges)" were to be explicit as to the level (or at least the means of calculation) of the origination payment which Ofcom would consider fair and reasonable.

(4) Requiring MNOs to have case by case recourse to the dispute resolution procedure to obtain those costs would create an unsatisfactory degree of protracted commercial uncertainty.

(5) Three suggests that the proper means of securing both zero rating and the MNOs' recovery of their efficient costs of origination would be to reissue 080 and 116 number ranges with a rights of use requirement attached to the use of numbers on those ranges that the CP to whom the numbers

---

7 [2011] CAT 24 at [400].
8 *Ibid.*

have been allocated pay an OCP's efficient costs of origination.

(6) Three's concerns about the proper approach to rights of use and the need to guarantee recovery of efficient costs of origination are explored in detail in the response to Questions 17.1 and 17.2 below.

(7) Although a retail-focused remedy may be the most appropriate zero-rating solution for the retail consumer issues Ofcom aims to address (albeit with due definition of the limited and exceptional circumstances that validate its implementation), Three's preference in the medium term would be that this was arrived at through the SMP regime. This is particularly the case given that there remain, regardless of the outcome of this consultation, significant concerns regarding functioning of the wholesale market (see Three's further comments on this at Question 17.1 below) and an inconsistency in the manner in which this is regulated as between geographic and non-geographic ranges. Three therefore believes that Ofcom should, in deciding to implement any retail remedies, commit to underpinning and validating the wholesale changes through a wholesale market review.

2. Three's response to Ofcom's questions

Part A – NGCS market assessment and summary of approach

Section 4 – Summary of concerns

Q4.1 Do you agree that the analysis set out in Section 4 and the supporting annexes which draws on our initial assessment in the December 2010 review, stakeholder comments and the further research undertaken in 2011, appropriately characterises the market, the market failures and the effects on consumers? If not please set out your alternative views.

11 Ofcom's characterisation of the non-geographic call services ("NGCS") market remains largely unchanged since the first consultation. Ofcom identifies three types of market failure in the NGCS market: lack of consumer price awareness, vertical externalities (OCPs do not take into account the impact of their pricing on SPs) and horizontal externalities (OCPs and SPs do not internalise the impact of their pricing on the reputation of the NGCS number ranges).

12 Based on the evidence, Ofcom conclude that these market failures have the following market effects on callers:

- a reduction in demand for non-geographic calls ("NGC"), particularly from mobile phones;
- the relative prices of non-geographic and geographic alls ("GC") do not reflect consumer preferences;
- loss of access to socially important services, particularly for vulnerable consumers; and
- loss of service diversity and innovation and SPs' lack of incentives to invest in the market[9].

13 Whilst we accept most of Ofcom's analysis, we disagree with Ofcom's interpretation of the evidence it relies on for proving that the relative prices of NGCs and GCs do not reflect consumer preferences. Ofcom's 2010 consumer survey on rebalancing of 080 prices shows that 59% of consumers are against rebalancing and only 16% are in favour of it[10]. Ofcom have dismissed this evidence as not reliable because the relevant question in the questionnaire was "densely worded" and "refers to conflicting price changes (i.e. free mobile 080 calls and higher prices for

---

[9] 2012 Consultation at [4.75].
[10] 2010 Consumer survey, page 24, Q39.

other services)"[11]. We disagree with Ofcom's interpretation. In our view, the question was unambiguous and the survey respondents understood it correctly. Therefore, we do not think the evidence supports Ofcom's conclusion that the relative prices of geographic and non-geographic calls do not reflect consumer preferences.

14 With regard to Ofcom's assessment of the relevant markets, Three notes that although Ofcom have identified a number of concerns at the wholesale level of the market[12], Ofcom remains of the view, previously expressed in 2010, that they are not confident that the termination rates that would arise commercially absent regulation would lead to desirable outcomes for consumers.[13]

15 Ofcom's focus in this consultation is on identified problems at the retail level of the market, and not the wholesale level. Ofcom consider that if their proposals do have the consequence of "*addressing wholesale imbalances*" that would merely be an "*additional benefit*" rather than the targeted consequence of the proposals.[14]

16 However, Three considers that despite the retail focus of this consultation, Ofcom must take full account of the current issues at the wholesale level of the market when determining the appropriate measures for the market. In addition to resolving consumer harm concerns, Ofcom remain subject to their duty to promote competition, which, as will be explained in more detail below, could be impeded by reason of imbalances in negotiating strength at the wholesale level of the market. Three believes the current proposals do not fully address all of the wholesale issues currently affecting the NGCS market, and therefore calls on Ofcom to carry out a full wholesale market review.

Section 5 – Equality impact assessment

Q5.1: Do you have any comments on our Equality Impact Assessment? In particular do you agree with our view that our proposals for changes to non-geographic numbers are likely to have an overall positive impact on the equality groups identified in Annex 15?

17 Three has no specific comments.

---

[11] 2012 Consultation at [16.125] – [16.130].
[12] 2012 Consultation at [4.76] – [4.78].
[13] 2012 Consultation at [4.76]. Ofcom also consider that that the concerns identified in Annex 10 of the 2012 Consultation would apply in relation to mobile 080 calls in the event that 080 is made free to caller (see 2012 Consultation at [17.30] and [17.35]).
[14] 2012 Consultation at [4.79].

Part B - the Revenue-sharing ranges

Section 9 – Remedies to address the market failures

Q9.1: Do you have any comments on our assessment, and in particular the additional evidence (gathered since the December 2010 Consultation) which we have used to support our assessment, on our provisional conclusion that the unbundled tariff should be applied to the revenue-sharing NGC number ranges?

18 Three supports Ofcom's conclusion that the unbundled tariff should be applied to the revenue-sharing number ranges, for which it is Three's preferred solution to Ofcom's identified concerns. Nevertheless, as Ofcom has not directly addressed the wholesale market more generally and the issues that arise specifically, Three considers that a full wholesale market review is still required in order to ensure that wider wholesale competition issues are addressed.

19 Three notes that Ofcom also consider and reject the maximum price option. We agree with Ofcom's assessment of this proposal. The maximum price option has a high risk of regulatory failure (as prices set by the regulator might not reflect consumer preferences) and also imposes a significant regulatory burden. In addition, Three remains of the view that setting maximum retail prices would also require regulating the wholesale market. Indeed, without corresponding wholesale regulation, the termination rates that would emerge commercially are likely to reflect the differing bargaining power of OCPs and TCPs of different sizes. OCPs are likely to be squeezed by TCPs owing to their market power in respect to NGCS number ranges. Notwithstanding the above, we do not consider that Ofcom have the legal powers to impose a maximum retail price in the absence of a SMP finding (for the reasons highlighted in our response to Question 16.1 below).

20 Overall, Ofcom's maximum price proposal has a number of significant drawbacks and therefore we consider Ofcom is correct in rejecting it.

Section 10 - Design of the unbundled tariff

<u>The Access Charge</u>

Q10.1: Do you agree with our proposal that the AC should be allowed to vary between tariff packages but that OCPs should be

subject to a tariff principle permitting only one AC for non-geographic calls? If not please explain why.

21 We agree that OCPs should be able to vary AC between tariff packages. OCPs should retain flexibility in order to offer customers a wide range of packages reflecting customers' preferences. However, we continue to maintain our position that there should be two ACs per tariff – an AC for 08 number ranges and an AC for 09/ 118 number ranges. Fraud levels tend to be significantly higher on 09/ 118 and this should be reflected in a higher AC for these number ranges.

Q10.2: Do you agree with our proposed structure for the AC, in particular that: (i) that the AC should be a pence per minute charge only, but can be subject to a minimum one minute call charge; (ii) that the AC should not vary by time of day; and (iii) that the AC can be included as part of call bundles/inclusive call minutes provided that inclusion does not differentiate by number range? If not please explain why.

22 We broadly agree with Ofcom's proposal. More specifically:

(i) We agree that the AC should be a pence per minute charge and a minimum one minute call charge ought to be permitted.

(ii) We agree that the AC should not vary by time of day.

(iii) We agree that OCPs should be allowed to include the AC as part of call bundles. However, we consider that when doing so OCPs should be allowed to differentiate between number ranges. For example, OCPs should be able to offer tariffs with the AC for 08 ranges included, but AC for 09/ 118 ranges excluded from the bundle. This differentiation is needed because of different levels of risk associated with 09/ 118 number ranges as a means of protecting OCPs from fraud.

Q10.3: Do you agree with our proposal not to impose a cap on the AC in the first instance? If not please explain why.

23 Yes, we agree for the following reasons. First, in our view, Ofcom does not have the legal powers to regulate prices at the retail level absent an SMP finding (please see our comments on this above and in our response to Question 16.1).

24 Second, even if Ofcom had these powers, Three considers that imposing a cap on the AC would be too intrusive, unnecessary and should be avoided in the future unless an SMP finding is made. Three believes that

tariff unbundling would improve transparency and ensure that customers are well aware of charges for non-geographic calls. Increased transparency would encourage customers to 'shop around' and to choose packages that would better reflect their preferences in relation to NGCS pricing.

The Service Charge

Q10.4: Do you agree with our proposed approach for the structure of the SC? In particular that: (i) bespoke SCs should be prohibited; (ii) that no further restrictions on the SC structure should be required (e.g. allowing ppm and ppc SCs, no restriction of ToD charging subject to ability of billing systems to pass through the charges). If not, please explain why and provide evidence if possible.

25 Three's view on the structure of the SC is as follows:

(i) Yes, we support Ofcom's proposal to prohibit bespoke SCs. Bespoke SCs cannot be effectively communicated to customers and will leave customers confused as to why SCs vary by a call originating operator. Existing bespoke termination rates already impose significant additional billing costs owing to their complexity, which increase administration costs and errors. Bespoke SCs would also potentially allow BT and other TCPs to price differentially, for different OCPs. We do not believe that such differential pricing is fair and reasonable, or in the interests of consumers.

(ii) We believe that ToD variations should not be allowed. However, should ToD variations be allowed, Three considers that each variation should count as a price point in its own right towards the overall maximum cap on the number of SCs. Three also believes, in light of Ofcom's proposal to impose maximum caps on the level SC at all times of the day, that the take up of such ToD variations in SC is likely to be low.

Q10.5: Do you agree with our proposals to impose maximum SC caps for the purposes of protecting the identity of the number ranges? Do you agree that the caps should apply to the 084, 087 and 09 ranges and that they should be set exclusive of VAT in the Numbering Plan? If not please explain why and provide evidence to support your position if possible.

26 Yes, we agree that SC caps should be imposed to protect the identity of the number ranges. The caps should be set exclusive of VAT in the Numbering Plan.

Q10.6: Do you agree with our proposed cap of 5.833p for the 084 range and 10.83p for the 087 range? If not please explain why.

27 Yes, we agree as these caps would limit the impact on SPs' revenue and should minimise migration.

Q10.7: Do you agree that the number of SC price points should be restricted? Do you agree that that restriction should be somewhere between 60 and 100, and where within that range do you consider would be optimal? Do you have any comments in relation to how Ofcom should decide where in that 60 to 100 range the maximum number of SC price points available should be set?

28 We believe that the number of SC price points should not exceed 60. Ofcom's analysis demonstrates that for 08 numbers, over 95% of traffic is within the top 10 price bands, and for 09 numbers, over 90% of traffic is within the top 20 price bands. In addition, the top four 118 numbers account for roughly 90% of all 118 call volumes[15]. Therefore, 34 price points currently serve more than 90% of all NGCS traffic.

29 Sixty price points would provide SPs with 26 additional price points to use if they want to differentiate themselves from the majority of SPs, especially given that Ofcom have proposed that the price points will not be restricted by number range. That would provide SPs with sufficient flexibility without overcomplicating the system and imposing disproportionate billing system costs on OCPs who will bear responsibility for passing on SCs to consumers.

Q10.8: Do you agree with Ofcom's proposed approach to agree the relevant SC price points with industry rather than specifying them as part of the Numbering Plan? Do you have a particular preference for which SC price points are necessary within the different number ranges? What criteria would you propose for the selection of price points?

[15] 2012 Consultation at [10.370], [10.376] and [10.380].

30 Three considers that, while it is reasonable for Ofcom to work with industry to establish the most appropriate SC price points, when these price points are agreed, Ofcom should specify them as part of the Numbering Plan. Ofcom should also impose a deadline by which an agreement should be reached in order to ensure that the implementation of the tariff unbundling proposal is not delayed.

Assumed point of handover

Q10.9: Do you agree with our assessment on the location of the AHP on BT's and other CPs' networks? If not, please explain why you disagree.

31 Yes, we agree with Ofcom's assessment that a near end handover regime provides incentives for the most efficient routing of NGCS calls.

Q10.10: Do you agree that for calls that route via a transit network, the TCP should pay for transit? If not, please explain why you disagree. In particular please explain your views on how incentives can be included within an "OCP pays" approach to ensure the TCP seeks to interconnect directly (where this is efficient) and not to reduce its points of interconnection at the expense of the OCP and efficient end to end call routing.

32 Yes, we agree that the TCP should pay for transit as this will ensure the most efficient routing of NGCS calls as well as ensuring symmetrical treatment of transit across the various NGCS ranges in question[16].

Q10.11: Do you agree with our proposed approach for calls between two non-BT CPs, both for the case when a transit network is used and for when direct interconnection is implemented? If not, please explain why you disagree.

33 Yes, we agree. If two CPs other than BT interconnect directly, they should be allowed to decide how to share the cost savings realised by not using a transit provider.

[16] We note Ofcom's comments in this regard in A18.20 of Part B Annex 18. We would like to clarify, since it appears that our previous comments in our consultation response of 31 March 2011 (p.22) have been taken out of context, that they were made in light of the asymmetric transit responsibility regime which currently applies to the transit of NGCS calls.

34 We also agree that if a transit network is used, the TCP should pay the transit provider for transit services.

Section 11 – the 0845 and 0870 ranges

Q11.1: Do you agree with Ofcom’s assessment that an unbundled tariff should also apply to the 0845 and 0870 ranges? If not please explain why.

35 Yes, we agree. Aligning 0845/ 0870 with the other 084 and 087 ranges would improve transparency and customer understanding of the unbundled tariff concept.

Section 12 – Implementation

Customer bills

Q12.1: Do you agree with our proposal not to mandate the presentation of disaggregated AC and SC charges on customers’ bills? Do you agree with our view that it should be up to OCPs to decide the best way to present these charges to their customers on bills OCPs but that we require that at a minimum, the OCPs should include the customer’s AC on the bill they receive?

36 Yes, we agree. Mandating the presentation of disaggregated ACs and SCs for each call on customer bills would require complex changes to OCPs’ billing systems, and such changes are costly and complex to implement. Three considers that it should be left to operators to decide how best to present information on bills to make it transparent and easy for customers to understand, while minimising the costs of upgrading the billing systems. For example, an OCP may choose to state the total cost of each call and to state the AC once for all non-geographic calls (if the AC does not vary by number range).

Wholesale issues

Q12.2: Do you agree with the requirement for a central SC database. If so what would be your preferred approach – public sector or private sector provision? If you do not agree with the need for the database what approach for the dissemination and verification of

SC would you prefer and why. Are there any other issues with respect to the database you would wish to raise?

37 We agree. For accurate billing, it is of critical importance that a centralised SC database is maintained accurately and kept up-to-date. All changes to SCs should take place on predetermined dates (e.g. 1st of each month) and should be communicated to OCPs at least 30 days in advance. Three considers that this database should be maintained by a public sector body (preferably Ofcom).

38 As acknowledged by Ofcom, some of the information required for a SC database already exists in Ofcom's Numbering Plan registry[17]. This registry also performs management functionality similar to what would be required for a SC database. There is also an existing established process for such work which is funded by Ofcom administration fees charged to the industry. Whilst Ofcom's existing systems may not be a full substitute for a central database of SC charges, we consider that it would be possible (at some cost of course) to adapt these to meet the relevant requirements.

39 In principle, the database could also be maintained by an independent private organisation (which is not involved in the telecoms market). However, we would be concerned if the SC database is maintained by a telecoms operators (either OCP or TCP), because it could give that operator some advantage (e.g. time advantage) over its competitors with regard to the availability of SC information.

40 In addition, if the database is maintained by a private organisation (rather than Ofcom), it may potentially increase the complexity of procuring an industry funded database and establishing industry processes and rules around its governance – a task which is not to be underestimated in light of the previous experiences with attempting similar objectives in the context of database for ported numbers.

Q12.3: Do you agree with the need for reformation of the existing processes for number range building and tariff change notification? If so, what do you consider to be the key characteristic of a revised set of processes? Do you consider that there is a need for regulatory intervention in their establishment, if so why and on what basis should Ofcom intervene.

[17] 2012 Consultation at [12.58].

41 Three does not consider that there is a need for a complete reformation of the existing processes for number range building nor regulatory intervention in their establishment. However, as the current process involving a yahoo email group mechanism for updating operators on number range building tends to be ad hoc, we believe that the proposed industry voluntary code of conduct with respect to the times and processes for building number ranges should be sufficient to address any concerns in this area.

42 As for tariff change notifications, Three agrees with the need for reformation of the existing processes in this area. It is critical for the success of Ofcom's unbundling proposal that the OCPs have access to consistent information in this regard in order to ensure that the consumers can be billed correctly. In particular, as noted above in response to Question 12.2, we agree that there should be a central database of SCs which acts as a central source of all tariff information from the point when a number range is made live and in relation to any further changes to tariffs. Further, any changes to tariffs should take place on predetermined dates (e.g. 1st of each month) and should be communicated at least 30 days in advance by way of predetermined periodic updates to the database.

Q12.4: Do you consider that there is a need for additional regulatory intervention in the area of end-users' access to non-geographic numbers, in addition to General Condition 20? If so why and what form should such an obligation take?

43 Three does not consider that there is a need for additional regulatory intervention in the area of end-users' access to non-geographic numbers. Providing access to a number range typically requires the OCP to accept the termination rate associated with that number range. Any regulation in this area therefore risks creating an end to end connectivity obligation on OCPs, i.e. an obligation to purchase, which must be properly justified. In Three's experience, refusal to open new number ranges on our network is typically associated with a high predicted risk of fraud associated with these new number ranges. In order to facilitate the process and reduce the risk involved in it, we consider that Ofcom should undertake more thorough due diligence checks on all companies applying for non-geographic ranges and investigate all fraud complaints (even if consumers are not directly affected). This will reduce the risk for OCPs and speed up the process of providing access to new NGN ranges.

44 In the absence of the identification of any specific market failure we do not see any need for regulatory intervention. Additional regulatory

intervention in this area also risks creating a raft of additional disputes - any range opened for which there is an unreasonable termination rate is likely to be immediately disputed. Ofcom must therefore weigh carefully any benefits of additional regulatory intervention with the additional burden of either enforcing "fair and reasonable" rates across the industry, or resolving a greater number of disputes than currently.

Communicating with consumers

Q12.5: What steps / actions do you consider need to be undertaken to ensure changes to the structure and operations of non-geographic numbers are successfully communicated to consumers?

45 Ofcom considers a number of steps that would allow Ofcom to communicate NGCS changes to consumers, such as:

- press releases – targeting national, regional and trade press;
- media interviews/appearances for key broadcasting outlets;
- information on Ofcom and PhonepayPlus websites – home page feature, consumer guide, consumer information;
- information to Ofcom's call centre about the changes;
- approach consumer websites to include information;
- social media engagement and other online information distribution channels, etc.

46 We agree with these actions proposed in the 2012 Consultation.

Price publication requirements

12.6. Do you agree with our proposal that existing price publication obligations (with some modifications) are sufficient to ensure that consumers are made aware of their ACs? Do you agree that we would need to specify the AC as a key charge?

47 Yes, we agree that existing price publications with modifications are sufficient to ensure that consumers are aware of their ACs. The AC should be specified as a key charge in these conditions.

Q12.7: Do you agree with our provisional view that the requirement for SPs to advertise their SCs could be implemented through a condition on SPs that is enforced through an industry Code of Practice and the ASA? Are there any other options (beyond the two outlined) which Ofcom should be considering? What do you consider is the best approach for securing industry commitment and developing a Code of Practice?

48 Yes, we agree that the requirement for SPs to advertise their SCs could be implemented through a condition on SPs and enforced through the CAP Advertising Code or an industry code of practice.

<u>Other implementation issues</u>

Q12.8: Do you agree internationally originated calls should be charged at the same SC as an equivalent domestic call? If not, please set out your reasons. Do you agree that originators should be able to set a separate AC level for roaming calls in a given country, though the other characteristics of the AC should still apply?

49 Yes, we agree that a separate AC level should be set for calls originated outside the UK, which may vary by country. However, we note that EU regulation only allows a minimum charging period of up to 30 seconds[18], while Ofcom's tariff unbundling proposal allows rounding up to the first minute. Therefore the AC structure may need to be modified for calls from the EU countries in order to comply with the EU regulation, i.e. it should be structured as 30sec + ppm rather than 1st minute +ppm.

Q12.9: We would welcome stakeholder views on our proposed approach for applying the unbundled tariff to payphones. Do you agree that it is appropriate to allow payphones to set a minimum fee for non-geographic calls*?*

50 We do not have a view on this issue.

Q12.10: Do you consider there is a need to exempt business to business telephony contracts from some of the constraints of the

[18] Regulation (EU) No 531/2012 of the European Parliment and of the Council of 13 June 2012 on roaming on public mobile communications networks within the Union (recast), article 8.2

unbundling regime? Is so what exemptions do you consider appropriate and why are they necessary (please give examples of the conflicts you would identify if exemptions are not provided). To which contracts should the exemptions apply and why?

51 Business tariffs, like all propositions, are brought to market on the basis of a positive business case analysis. Likewise, a customer will enter in to a tariff on the basis of the charges set out at the time of signing. Where regulation is introduced that may fundamentally alter critical financial inputs in this equation it risks fundamentally altering the basis of this bargain, potentially to the significant detriment of one or both parties. It also undermines business certainty more generally and therefore risks reducing innovation in the market. Ofcom should therefore be slow to intervene in existing contractual relationships.

52 Nevertheless, we believe that in the present case the duration of any implementation period will be adequate to allow providers of business telephony to churn on to contracts which foresee the changes proposed, or for any renegotiation necessary for longer contracts to be concluded. We therefore do not consider that business to business telephony contracts should be exempt from the unbundling regime. Any exemptions would make implementation more complex. It might also affect consumers' understanding of unbundled tariffs if they face different price structure in the retail and business context.

<u>Timing</u>

Q12.11: Do you agree with our proposal that implementation should take place 18 months from the date of the final statement?

53 We believe that introduction should take place as soon as commercially possible. We believe 18 months is a reasonable timeline.

Section 13 - Impact assessment

Q13.1: Do you agree with our estimates of the billing costs for implementing the unbundled tariff, taking into account the discussion in Annex 19? If not, please explain why and provide evidence to support your response, particularly of the level of costs you are likely to incur as a result of our proposals.

54 We agree.

Q13.2: Do you agree with our estimates of the level of migration and misdialling costs for service providers who may migrate as a result of the unbundled tariff (taking into account the analysis and evidence in Annex 12)? If not please explain why and provide evidence.

55 Three does not host SPs and therefore we are not in a position to comment on SPs' incentives to migrate as a result of tariff unbundling and the costs associated with it.

Q13.3: Do you agree with our estimates of the communication costs of implementing the unbundled tariff? In particular: (i) the costs of OCP communication with their customers; and (ii) the costs of TCP communication with their SP customers. If not, please explain why and provide evidence to support your response, particularly of the level of costs you are likely to incur as a result of our proposals.

56 Ofcom estimates that the cost of OCP communication with their customers to be in a range of £0.4m - £2.7m for the industry as a whole. These costs include call centre costs, new printed material for notifying customers and changes to existing printed materials. Assuming Three's market share is [✂] and allocating these costs *pro rata*, Ofcom's estimates suggest that Three's costs would be [✂].

57 However, based on our past experience of communicating price changes to customers, we estimate our costs to be [✂]. This suggests that Ofcom has potentially underestimated the costs to OCPs by up to [✂]. As noted below, even at this increased cost, cost benefit analysis will remain positive.

Q13.4: Do you have any comments on our impact assessment for the unbundled tariff? Please provide evidence to support your response.

58 Three broadly agrees with the methodology used by Ofcom to assess the costs and benefits of the unbundled tariff. However, as discussed in our response to Question 13.3 above, we believe that Ofcom have potentially underestimated the OCP communication costs by up to [✂]. This would obviously have an impact on the total costs and net benefits of the unbundled tariff. However, we do not expect it to change the conclusions drawn from the impact assessment because, even with higher communications costs, the net benefits of the unbundled tariff are likely to be positive and significant.

Part C - Freephone and 116

Section 16 – Assessment of options

Q16.1: Do you agree with our assessment of the options for the 080 range? In particular, do you agree with our preferred option of making 080 genuinely free to caller? If not, please explain why.

59 As set out above, Three supports the need to promote price awareness among consumers and considers the zero rating proposal will bring the greatest benefits to consumers so long as efficient cost recovery for OCPs is guaranteed.

60 Ofcom propose:

- to zero rate all calls to 080 by modifying or introducing a General Condition;
- to impose a maximum retail price in relation to the provision of electronic communications services provided by means of non-geographic numbers[19]; and
- to rely on their powers in s.51(1)(a) and most particularly s.58(1)(aa) CA.[20]

61 Ofcom's view that they have the power to regulate retail price in the absence of a finding of SMP is premised on amendments to the EU common regulatory framework for electronic communications networks and services ("CRF"), which have since been transposed into UK law by amendments to the CA.

(1) The particular amendment to the CRF which is relied upon by Ofcom is one to Annex C of the Authorisation Directive[21] under which the conditions which may be attached to rights of use for numbers include "*[d]esignation of service for which the number shall be used, including any requirements linked to the provision of that service* *<u>and, for the avoidance of doubt, tariff principles and maximum prices that can apply in the specific number range for the purposes of ensuring consumer protection in accordance with Article 8(4)(b) of Directive</u>*

---

[19] 2012 Consultation [17.116] – [17.120] and [17.127].

[20] Three also notes that Ofcom also propose to rely on s.58(1)(aa) to implement the unbundled tariff proposal, namely to implement regulation of the Access Charge: see 2012 Consultation [13.69].

[21] Directive 2002/20/EC of the European Parliament and of the Council on the authorisation of electronic communications networks and services, amended by Directive 2009/140/EC.

<u>*2002/21/EC (Framework Directive).*</u>" (amendment emphasised).

(2) S.58(1)(aa) was inserted to the CA during the transposition of the amendments to the CRF into UK legislation. That section provides that conditions about the allocation and adoption of numbers can "*impose tariff principles and maximum prices for the purpose of protecting consumers in relation to the provision of an electronic communications service by means of telephone numbers adopted or available for use."* It is this power which Ofcom envisage using to impose a maximum retail price of zero on OCPs when they originate calls to 080 numbers.

The correct interpretation of "rights of use"

62 A number of stakeholders, including Three, raised doubts about whether the conditions which may be attached to "*rights of use*" under Annex C could be used to impose conditions on OCPs. Annex C allows for the imposition of tariff principles and maximum prices on those undertakings which enjoy "*rights of use for numbers*". In its response to the 2010 Consultation, Three took the position that OCPs do not exercise "*rights of use*" within the meaning of the Authorisation Directive, and that Annex C conditions can apply only to undertakings to whom such rights are "*granted*" (to use the language of the Directive), namely the undertakings to whom such numbers are allocated by Ofcom and the undertakings which terminate calls on such numbers, i.e. SPs and TCPs.

63 Ofcom have considered and rejected this position (which they call the "narrow interpretation") in favour of a wider interpretation under which "*rights of use*" covers "*the activities of an OCP conveying a call by one of its customers to a non-geographic number and then billing the customer for that call*".[22]

64 Ofcom set out three arguments for the rejection of the narrow interpretation of "*rights of use*" at [5.57] – [5.59] 2012 Consultation. Three's concerns in relation to these arguments are as follows:

1) It is not obvious that access and use by end-users of non-geographic services can only be achieved if the OCP has a "*right of use*" of the number in question[23]:

[22] 2012 Consultation [5.58].
[23] The argument raised by Ofcom at 2012 Consultation [5.57].

(a) this argument begs the question of the correct interpretation of "*right of use*"; and

(b) the reliance on Annex A(4) is misplaced. There is a strict separation[24] between conditions on the general authorisation in Annex A and conditions on the right of use in Annex C. Annex C should not duplicate Annex A conditions.[25] The fact that Annex A (rather than Annex C) already codifies the provision of Article 28 Universal Service Directive in fact supports the narrow interpretation of "*rights of use*".

2) Ofcom's argument at [5.58] relying on the meaning of "*allocation*" in the CA is of no assistance in interpreting the requirements of the Authorisation Directive. The Authorisation Directive uses language of "*grant*", and the "*rights*" to which the Authorisation Directive refers are rights that, as seen from the other provisions of the Directive, are transferrable, tradable and granted following an administrative procedure. That would not on its face appear to include the conveyance of a call by an OCP to a particular number.

3) As to the third argument raised by Ofcom at [5.59], the difficulty of demonstrating that consumer protection requires wholesale regulation does not mean that the consumer protection purpose would be defeated by the narrow interpretation. It simply means that the price regulation is only available in limited circumstances, which is entirely consistent with the general approach in the CRF.

65 Three also notes that Ofcom's interpretation of "rights of use" is inconsistent with that set out in the current General Conditions. Should Ofcom persist in its current interpretation then this will raise uncertainty regarding the rights and obligations applicable to industry participants. This would not only increase the burden on Ofcom (through additional disputes) but would also be directly contradictory to its own aims and obligations.

66 Three remains of the view that the correct interpretation of the term "*rights of use*" in the Authorisation Directive is that it applies to the activities of TCPs/SPs. The activities of TCPs/SPs undoubtedly fall within the meaning of "*rights of use*". As set out below in the response to Question 17.1, Three considers that attaching conditions to the rights of

[24] See the Commission Proposal for Directive 2002/22/EC COM(2000)386 at para 3 and the explanation to the proposed Article 6.
[25] Article 6(4) Authorisation Directive.

use for 080 and 116 numbers is a mechanism which Ofcom ought to use in order to guarantee payment to OCPs of their efficient costs of origination if zero rating is implemented.

The borderline between regulation by SMP conditions and regulation by authorisation conditions

67 Despite the doubts expressed above about Ofcom's reasons for rejecting the "*narrow interpretation*", Three's predominant concern in relation to this issue is that Ofcom avoid using the powers they consider they have in a way which contradicts the general approach to price regulation in the CRF,[26] particularly in light of the uncertainty[27] over the extent of Ofcom's power in s.58(1)(aa). If Ofcom consider they do have the power to regulate retail price in the absence of SMP for the purpose of ensuring consumer protection, it is vital they define the limited and exceptional circumstances in which such a power could be exercised.

68 Three is concerned that Ofcom's interpretation of their legal powers risks eroding the fundamental principle that price regulation is a measure of last resort, contingent upon a finding of SMP.

69 On Ofcom's interpretation of its powers, difficult questions arise as to the borderline between the power to directly regulate retail prices with the aim of consumer protection (which Ofcom argues is unconstrained by the need to make a finding of SMP) and the power to regulate by way of SMP condition.

70 In the 2012 Consultation Ofcom appear to suggest that the dividing line between the tightly constrained power to regulate by way of SMP condition and the relatively unconstrained[28] power to regulate under

[26] The CRF envisages regulatory intervention in circumstances where it has been shown that an operator has SMP. In essence, the CRF established a mechanism allowing national regulators, where there is no effective competition on a relevant market, to impose ex ante regulatory obligations on undertakings in the electronic communications sector designated as having significant market power following an analysis of the market concerned. Case C-58/08 *Vodafone v Secretary of State for Business* at [3]. As to regulatory controls on retail services, under the general approach in the CRF those can only be adopted in the event there is no effective competition in the retail market, and wholesale measures are ineffective in promoting competition (see Article 17(2) Universal Service Directive).

[27] For the avoidance of doubt, Three remains of the view that the interpretation of "rights of use" adopted in Three's 2011 response is correct. Uncertainty in the extent of Ofcom's powers results from the fact that Ofcom have taken the view that they have the power to regulate retail price in the absence of SMP, despite a number of operators contending that that is not the case.

[28] Albeit that Ofcom recognise that the exercise of the power under Annex C is contingent on a finding that regulation is required for consumer protection and is, of course, subject to the usual requirement that the imposition of a condition be objectively justifiable, not unduly discriminatory, proportionate and transparent under s.47(2) CA.

s.58(1)(aa) (by way of an Annex C condition) is whether the purpose of Ofcom's proposed condition is "*targeted*" at consumer protection or "*targeted*" at promotion of competition.[29]

71 However, there is no clear distinction between consumer protection and the promotion of competition. That the two may be intertwined is evident from Ofcom's principal duty "*to further the interests of consumers in relevant markets, where appropriate by promoting competition*" (s.3(1)(b) CA).

72 Three submits that an approach based on whether the "target" of the measure is consumer protection or promotion of competition[30], is inadequate to prevent further future erosion of the general principle that price regulation can only be imposed in the event of a finding of SMP.

73 If Ofcom remain steadfast in their view that they have the power to regulate retail price absent a finding of SMP, they must acknowledge the radical nature of any such power. It must surely be only in exceptional and compelling circumstances of consumer detriment that any retail price regulation could be imposed. If Ofcom consider they have the power to regulate retail price for the purposes of consumer protection under s.58(1)(aa) then Ofcom must define the boundary between that power and the power to regulate by way of SMP conditions. Given the general approach to retail price regulation in the CRF the circumstances in which any such former power (if it exists) can be exercised must be extremely limited and highly exceptional.

Q16.2: Do you have any comments on the analysis used to develop the Impact Assessment Range for the mobile origination charge and the Mobile Maximum Price range for 080 calls as set out in Annexes 21 to 25? Please provide evidence to support your comments.

74 We agree with the analytical framework that Ofcom has adopted in determining its Impact Assessment Range for mobile origination points, i.e.:

- Principle 1: mobile OCPs should not be denied the opportunity to recover their efficient costs of originating calls to a free to caller number range.
- Principle 2: the mobile origination payment should:

[29] 2012 Consultation [5.53].
[30] An approach seemingly adopted by Ofcom at paragraph [5.53] 2012 Consultation.

- o provide benefits to consumers, taking into account indirect and tariff package effect; and
- o avoid a material distortion of competition either among OCPs or among TCPs.
- Principle 3: the mobile origination payment should be reasonably practicable to implement[31].

75 Based on the assessment of Principles 1-3 above, Ofcom suggest an Impact Assessment Range of 2.5-3.0ppm for the mobile origination payments. This range broadly corresponds to Ofcom's estimates of call origination costs based on LRIC+ methodology with no contribution to acquisition and retention cost recovery (lower bound) and LRIC+ with 50% contribution to acquisition and retention cost recovery (upper bound) (see Table 1).

Table 1: Ofcom's cost estimates

2013/14 origination cost (ppm, 2011/12 prices)[32]	Pure LRIC	LRIC differential	LRIC+ (no A&R recovery)	LRIC+ (50% A&R recovery)	LRIC+ (100% A&R recovery)
Network	0.67	1.07	1.45	1.45	1.45
Administration	-	-	0.17	0.17	0.17
Customer care	0.00 -0.09	0.00 - 0.09	0.23	0.23	0.23
A&R[33]	-	-	-	0.79	1.57
Other CARS[34]	-	-	0.46	0.46	0.46
Total	0.67 - 0.76	1.07 - 1.16	2.31	3.10	3.88
Total (rounded)	0.7 - 0.8	1.1 - 1.2	2.3	3.1	3.9

Source: *Ofcom consultation, Tables A22.8 and A22.9.*

76 We are concerned that Ofcom, in the Impact Assessment Range analysis, have understated the costs of mobile call origination and therefore have potentially violated Principle 1 above. More specifically, in arriving at these estimates, Ofcom have relied on two assumptions, both

[31] 2012 Consultation at [A23.28].
[32] The estimates summarised and discussed here relate to calls to a "free to caller" number range. Ofcom estimates marginally higher costs for calls to a "Maximum Mobile Price" number range. The points raised here apply *mutatis mutandis* to such calls.
[33] Customer Acquisition and Retention ("A&R") costs include handset costs, marketing and advertising, discounts and incentives, and sales costs ([A22.17]).
[34] Other Customer Acquisition, Retention and Service ("CARS") costs, not clearly identified by Ofcom as belonging to the categories of A&R, customer care, billing or bad debt costs ([A22.30]).

of which Three considers to be incorrect and inconsistent with Ofcom's approach to regulating Mobile Call Termination ("MCT") charges. We consider that:

1) assumed inflation between 2008/09 and 2011/12 is understated, as it is based on outdated forecasts rather than actual data; and
2) the three LRIC+ estimates all assume that common costs are recovered from all services, including MCT, whereas in fact no common costs should be recovered from MCT.

Ofcom should use the actual inflation

77 Three considers that it would be inconsistent for Ofcom to base its assessment of origination charges on outdated forecast inflation figures, while at the same time continuing to regulate mobile termination charges on different assumptions.

78 Ofcom source their estimates of the network and administration elements of origination cost from the 2011 MCT model[35], which expresses costs in 2008/09 prices[36], and the estimates of CARS costs (including customer care, A&R, and other CARS costs) from 2009 data[37]. In both cases, the source figures need to be adjusted for inflation to 2011/12, the price basis adopted for assessing origination costs in the consultation.

79 Ofcom state that this has been done using the inflation values in the 2011 MCT model which assumes forecast inflation of 2.5% per year[38].

80 The actual rate of inflation between 2008/09 and 2011/12 is now known, and is higher than the rate forecast in the 2011 MCT model. Given the availability of actual data, it would be invalid to continue to rely on outdated forecast estimates. Moreover, such continued reliance would be inconsistent with Ofcom's approach to regulating MCT charges, which explicitly takes latest actual outturn inflation data into account[39].

81 The inflation adjustments applied to the data sources should therefore be updated accordingly:

---

[35] 2012 Consultation at [A22.22].
[36] Ofcom March 2011 MCT Statement at [A6.34].
[37] 2012 Consultation at [A22.27].
[38] Footnote 39 to Table A22.1.
[39] See, for example, *Mobile call termination: Adoption of revisions to SMP Conditions in accordance with the directions of the Competition Appeal Tribunal of 8 May 2012*, Ofcom, 10 May 2012.

1) figures generated by the MCT model, in 2008/09 prices, should be inflated by 12.9% to be stated in 2011/12 prices[40]; and
2) CARS costs figures, expressed in 2009 prices, should be inflated by 11.3% to be stated in 2011/12 prices[41].

In contrast, it appears that Ofcom's calculations assume an inflation uplift of 6.2% for both sets of figures[42].

82 Applying the revised inflation adjustments to the source figures results in the following revised cost estimates:

Table 2: Ofcom's cost estimates, adjusted for actual inflation

2013/14 origination cost (ppm, 2011/12 prices)	Pure LRIC	LRIC differential	LRIC+ (no A&R recovery)	LRIC+ (50% A&R recovery)	LRIC+ (100% A&R recovery)
Network	0.71	1.11	1.54	1.54	1.54
Administration	-	-	0.19	0.19	0.19
Customer care	0.00 - 0.09	0.00 - 0.09	0.24	0.24	0.24
A&R	-	-	-	0.82	1.65
Other CARS	-	-	0.48	0.48	0.48
Total	0.71 - 0.80	1.11 - 1.20	2.45	3.28	4.10
Total (rounded)	0.7 - 0.8	1.1 - 1.2	2.5	3.3	4.1

Source: *Three's estimates.*

No common cost recovery from termination

83 Ofcom derives its LRIC+ estimates for network and administration costs from an unadjusted version of the 2011 MCT model[43]. That model

[40] Inflation calculations are based on RPIX, in line with the approach adopted in the 2011 MCT model (row 22, Parameters, Cost). Data from the Office of National Statistics indicates an average RPIX for 2008/09 of 209.7 (taking an average of every month in 2008/09), and an average RPIX for 2011/12 of 236.7, an increase of 12.9%.

[41] Data from the Office of National Statistics indicates an average RPIX for 2009 of 212.6, and an average RPIX for 2011/12 of 236.7, an increase of 11.3%.

[42] Although Ofcom does not directly cite the figure of 6.2% in the consultation, it is implied by a number of figures cited, including the figure of £181m for administration costs in Table A22.5 (compared with a figure in the 2011 MCT model of £170.49m, at row 235, Service costing, Economic), and the figure of £1,602m for CARS costs in paragraph A22.27 (compared with a 2009 figure of £1,508m in the same paragraph). It is not clear how the figure of 6.2% has been derived. For example, the inflation values in the 2011 MCT model, which Ofcom claims to have used, suggest an uplift of 8.7% between 2008/09 and 2011/12, based on inflation of 3.5% for 2009/10, 2.5% for 2010/11, and 2.5% 2011/12 (row 22, Parameters, Cost).

[43] 2012 Consultation at [A22.25].

assumes that common costs are recovered from all services, including MCT. Three considers that this is now an invalid assumption, since Ofcom's current approach to regulating MCT charges does not allow the recovery of any common costs from MCT charges[44].

84 We believe that it would be inconsistent for Ofcom to base the regulation of origination charges on the assumption that common costs are recovered from MCT, while at the same time continuing to regulate MCT charges on the assumption that no common costs are recovered from MCT.

85 Ofcom does partially acknowledge this issue in the consultation[45], but instead of revising its LRIC+ estimates accordingly, it considers the issue solely in the context of the 3.0ppm upper end of its "Impact Assessment Range"[46]. Ofcom indicate this partial recognition is to avoid pre-empting discussion of the complex issue of:

"*which services should make up for the impact on fixed and common cost recovery of setting termination rates on a pure LRIC basis*" [47].

86 Ofcom may be correct to suggest that the issue of common cost recovery from services other than MCT is complex, and it may not be proportionate to explore that issue fully as part of the current consultation. However, while this might suggest the adoption of a simple assumption for common cost recovery from services other than MCT, it cannot justify the adoption of an assumption that is logically impossible, i.e. that common costs are recovered from all services, including MCT. Given the indisputable fact that no common costs are recovered from MCT, Three considers that the most appropriate simple assumption is common cost recovery from services other than MCT on an Equi Proportionate Mark Up ("EPMU") basis.

87 In addition to being more appropriate, such an alternative assumption would resolve the current unwarranted logical inconsistencies within Ofcom's approach, namely:

- reflecting the current regulatory regime for MCT in considering the 3.0p upper end of the "Impact Assessment Range", but ignoring the regime in considering the 2.5p lower end of that range[48]; and

---

[44] It could be argued that some common costs are in effect recovered from MCT charges during the glide path that takes them to their pure LRIC level. However that glide path will have expired by 2013/14, the year for which Ofcom estimates origination costs.
[45] Table A22.8 (note), Para. A22.60.
[46] Para. A23.105 – A23.110.
[47] Para. A23.107.
[48] 2012 Consultation at [A23.108].

- relying on LRIC+ estimates that simultaneously assume that some common costs (relating to network and administration costs) are recovered from all services, including MCT, but that other common costs (relating to CARS costs) are recovered from all services other than MCT[49], without any good reason being presented for the difference in treatment.

88 Recovering common costs in the 2011 MCT model from services other than MCT on an EPMU basis, in addition to applying the revised inflation estimates set out above, results in the following revised cost estimates[50]:

Table 3: Ofcom's cost estimates, adjusted for actual inflation and common cost

2013/14 origination cost (ppm, 2011/12 prices)	Pure LRIC	LRIC differential	LRIC+ (no A&R recovery)	LRIC+ (50% A&R recovery)	LRIC+ (100% A&R recovery)
Network	0.71	1.11	1.83	1.83	1.83
Administration	-	-	0.24	0.24	0.24
Customer care	0.00 - 0.09	0.00 - 0.09	0.24	0.24	0.24
A&R	-	-	-	0.82	1.65
Other CARS	-	-	0.48	0.48	0.48
Total	0.71 - 0.80	1.11 - 1.20	2.79	3.62	4.44
Total (rounded)	0.7 - 0.8	1.1 - 1.2	2.8	3.6	4.4

Source: *Three's estimates*

Impact Assessment Range

89 The revised cost estimates have a significant impact on Ofcom's assessment of its 2.5p to 3.0p "Impact Assessment Range". In the consultation document, Ofcom concludes that a charge at the lower end of this range is reasonable, on the basis that it recovers LRIC+, there estimated at 2.3p (excluding A&R costs), plus a recovery of 0.2p or more for A&R costs[51].

[49] Footnote 58, Table A22.5.

[50] Network and administration costs, including common cost recovery from services other than MCT, have been calculated from the 2011 MCT model by removing MCT traffic from the model altogether (at rows 140 and 146, Traffic Forecast, Traffic), and then running the model in LRIC+ mode. This is slightly different from the approach set out by Ofcom in Paragraph A22.60, but more consistent with the approach to regulating MCT charges. Under the approach suggested here, the impact of MCT is excluded over the entire lifetime of the network, in line with the approach to regulating MCT charges, and common costs are recovered from remaining services over the entire lifetime of the network, in line with the Economic Depreciation approach.

[51] Paragraphs A23.102 and A23.108. The recovery of 0.2p for A&R costs corresponds with the bottom end of the range, 2.5p. To the degree that Ofcom's reference to the lower end of the

90 Applying exactly the same reasoning, but correcting it for the errors identified above, which now generate a LRIC+ estimate of 2.8p (excluding A&R costs), suggests origination charges should be set at 3.0p or above.

Q16.3: Do you agree with our estimates of the level of migration and misdialling costs for service providers who may migrate as a result of our proposal to make the 080 range free to caller (taking into account the evidence and analysis in Annex 12)? If not please explain why and provide evidence.

91 We are not in a position to comment on SPs' levels of migration as we do not host SPs. However, we note that if Ofcom have underestimated the level of migration, this would obviously affect the Impact Assessment.

92 Ofcom predict that traffic from mobile to 080 numbers would increase 8 to 10 fold and that OCPs would financially benefit from the proposal. However, if more SPs migrate than predicted by Ofcom, the overall volume of calls to 080 numbers might drop and OCPs may be significantly worse off.

93 Three also considers that in order to minimise migration of SPs from Freephone ranges, Ofcom should attempt to minimise SPs *total costs*, i.e. both the hosting costs and the origination payments. While Ofcom has rigorously analysed the latter, no similar analysis of the former has been undertaken. Given that Ofcom is highly mindful of SPs' willingness to pay, but has only considered this in the context of costs of origination, Ofcom should consider the scope for changes to both. We would therefore welcome confirmation from Ofcom that both hosting charges and origination charges will be assessed so that SPs can be confident that both hosting and origination charges for 0800 are covering only costs. Should Ofcom consider hosting charges outside the scope of this review then it should be a matter for commercial negotiation between SPs and TCPs, and not threaten OCPs' right to cost-recovery. OCPs should not be penalised in cost-recovery if hosting charges are not cost-reflective and raise the total cost to SPs to a level they are unwilling to pay.

range of 2.5p to 3.0p refers to charges above 2.5p, this suggests recovery of more than 0.2p for A&R costs.

Q16.4: Do you agree with our proposal to treat the 116 ranges in the same way as the 080 range (i.e. designate all as free to caller) as set out in detail in Annex 27? If not please explain why.

94 We do not see any reasons why the 116 ranges should be treated differently from the 080 ranges.

Section 17 - Implementation

Q17.1: Do you agree with our provisional view that it is appropriate for an access condition to be imposed on all TCPs hosting designated Free to caller numbers requiring them to:

(i) purchase wholesale origination services for calls terminating on designated free to caller ranges from any requesting OCP;

(ii) to do so on fair and reasonable terms and conditions (including charges); and

(iii) notify their SP customers of any initial revision to the charges for wholesale origination services within two months of Ofcom imposing the requirement for zero maximum prices.

If not do you consider any ex ante intervention is required? Please give your reasons for or against such intervention and your preferred approach.

95 Three would like to make the following comments on Ofcom's proposals for the implementation of zero-rating for calls to 080 numbers.

96 Three accepts that the focus of Ofcom's review is a concern about the retail market and consumer harm, rather than a concern about competition at the wholesale level.[52] However, Ofcom must not lose sight of issues at the wholesale level of the market and their parallel duty to promote competition.[53] That duty requires Ofcom to provide a mechanism whereby Three is able to recover its efficient costs of originating calls to 080 numbers at the wholesale level, given that were zero rating to be adopted Three could no longer recover those costs at the retail level.

[52] 2012 Consultation at [5.79] – [5.85] on the consumer focus of the review and [6.7] (which identifies the problems which Ofcom seek to address as "*an interrelated set of market failures which are linked to consumer perception of the non-geographic number ranges*"). See also [4.79] in which Ofcom expresses the view that wholesale regulation would not have the effect of remedying the retail concerns identified.

[53] s.3(4)(b), and s.4 CA 2003.

97 Three's support in principle for zero rating is entirely conditional upon the provision by Ofcom of a mechanism which will guarantee originating networks recovery of the efficient costs of origination of 080 calls. Three is concerned about the ability of Ofcom's proposed access condition to provide such certainty of recovery.

98 Three seeks reassurance from Ofcom about the effectiveness of the proposed access condition to enable OCPs to recover their efficient costs and the certainty that such costs can be recovered without having to resort to protracted disputes. We urge Ofcom to consult on guidance as to how the access condition is to be interpreted and applied as soon as possible, and for such guidance to be in place before Ofcom mandates a move to zero rating of 080 numbers. Moreover, Three considers that attaching a condition that the TCP/SP pay the efficient costs of origination of an OCP to the rights of use for 080 and 116 numbers would provide greater reassurance to OCPs that they will be able to recover those costs than the proposed access condition.

99 The following sections outline Three's view as to: (i) the risks of zero rating (**Section I** below); (ii) the issues at the wholesale level of the market which need to be considered by Ofcom when seeking a solution to address those risks (**Section II** below); (iii) the need for certainty of recovery of origination payments (**Section III** below); and (iv) the proposed access condition (**Section IV** below.)

I. The risks of making calls free to callers

100 In paragraph 17.4 of the Consultation, Ofcom identify a number of potential risks in making calls to 080 and 116 ranges free to caller, including:

1) Wholesale arrangements: including the setting of origination charges (whether by commercial agreement or regulatory intervention) and the level of such charges.
2) SP migration and call blocking: including migration away from Freephone ranges by SPs.
3) Communication to consumers of the changes to 080 retail pricing.

101 Three agrees that each of these poses a potential risk to the implementation of Ofcom's proposal, and ought to be considered and addressed as part of the consultation process. However, Three is particularly concerned by Ofcom's proposals for addressing the risks around wholesale arrangements because Ofcom:

1) recognise that under zero rating mobile OCPs will suffer a significant loss of retail revenues[54];

2) intend that "*the majority (if not all) of this revenue could be made up through the origination charge and the increase in the proportion of calls made to 080 numbers from a mobile*";[55] but

3) acknowledge there is a real risk that the actual future mobile origination payments will not fall within Ofcom's assumed Impact Assessment Range.[56]

102 Ofcom's solution to the risk that origination payments will not fall within the assumed Impact Assessment Range is an access condition requiring TCPs to purchase wholesale origination services on fair and reasonable terms.[57]

103 Three is concerned about how the access condition will be implemented in practice. We fear that, despite Ofcom's good intentions, the eventual result of imposing a condition on such terms and relying on the agreement of "*fair and reasonable terms and conditions (including charges)*", will be protracted disputes and litigation between mobile OCPs and TCPs.

II. Wholesale Arrangements

104 Ofcom have identified a number of concerns at the wholesale level of the market[58] and remain of the view, previously expressed in 2010, that they are not confident that the termination rates that would arise commercially absent regulation would lead to desirable outcomes for consumers.[59]

105 As noted above, Ofcom's focus in this review is on identified problems at the retail level of the market, and not the wholesale level. Ofcom consider that if their proposals do have the consequence of "*addressing wholesale imbalances*" that would merely be an "*additional benefit*" rather than the targeted consequence of the proposals.[60]

---

54 2012 Consultation at [16.255], a paragraph in which Ofcom notes that in 2009 mobile OCPs earned retail revenues of £75 million from 080 calls.
55 2012 Consultation at [16.255].
56 2012 Consultation [16.209] and Table 16.16 which recognises as a "*Regulatory burden*" the "*uncertainty about origination payment that will actually arise*".
57 2012 Consultation [16.209].
58 2012 Consultation at [4.76] – [4.78].
59 2012 Consultation at [4.76]. Ofcom also considers that that the concerns identified in Annex 10 of the 2012 Consultation would apply in relation to mobile 080 calls in the event that 080 is made free to caller (see 2012 Consultation at [17.30] and [17.35]).
60 2012 Consultation at [4.79].

106 However, Three considers that despite the retail focus of this review, Ofcom must take full account of the current issues at the wholesale level of the market when determining the appropriate measures for implementing zero rating at the retail level, for the following reasons:

1) Ofcom remain subject to their duty to promote competition, as part of which Ofcom must not prevent Three's recovery of its efficient costs of origination, which could be impeded by reason of imbalances in negotiating strength at the wholesale level of the market.

2) Ofcom's preference for zero rating fundamentally depends on the assumption of certain events occurring at the wholesale level, namely that there will be a movement of the recovery of costs of origination from the retail level (in the retail call charge) to the wholesale level (in an increased origination payment). A lynchpin of Ofcom's preference for zero rating is the understanding that it will not involve an increase of cost to OCPs but that it merely represents a "*rebalancing of payment"* in that it changes who pays for the cost of origination.[61] Ofcom's preference for zero rating as a solution to problems at the <u>retail</u> level of the market is based upon the assumption that OCPs will be able to recover their efficient costs of origination by way of an origination payment. That origination payment will be negotiated at the <u>wholesale</u> level of the market.

107 Accordingly, issues about the wholesale market must be fully considered by Ofcom in determining the appropriate mechanism to ensure MNOs can recover their costs of origination other than at the retail level upon any entry into effect of zero rating.

108 Three submits that the issues at the wholesale level which are predominantly relevant to this response are:

1) the imbalance in BT's Standard Interconnect Agreement ("SIA") which is the mechanism under which negotiation for the majority of origination payments will take place; and

2) the frequency of disputes between CPs in relation to the fairness and reasonableness of wholesale termination rates. [62]

---

[61] 2012 Consultation at [16.259].

[62] See for example, disputes CW/01036/03/09 ("the 080 dispute"), CW/01042/01/10 ("the 0845/0870 dispute")**,** CN/01055/08/10 ("the second 080 dispute (NCCN 1007)") and CW/01088/03/12 ("the NCCN 1101 and 1107 dispute").

109 Two concerns relating to the SIA are addressed in the Annex A. Three considers the concern about the frequency of disputes in section IV below, when considering the need for guidance from Ofcom on the operation of the proposed access condition.

III. The need for certainty that origination payments will cover the efficient costs of origination

110 At paragraphs [17.32] to [17.34] of the Consultation, Ofcom highlight the importance to TCPs and SPs of having certainty with regard to the origination payment for Freephone calls. Ofcom states that "*concerns over certainty are legitimate, and uncertainty would be likely to lead to detrimental outcomes for consumers*". Three emphasises that the need for certainty in this regard is not limited to the interests of TCPs and SPs.

The need for MNOs to recover their efficient costs of origination

111 For mobile OCPs, the need for certainty regarding origination cost recovery is essential. Mobile OCPs will no longer be able to recover those costs at the retail level if zero rating is adopted. As Ofcom recognises, mobile OCPs have a higher cost of origination than fixed OCPs.[63] If a mobile OCP is to be required to zero rate calls to Freephone number ranges at a retail level, it needs certainty that those costs of origination will be covered by the payments made to it by TCPs and ultimately, SPs.

112 The principle that OCPs ought to recover their efficient costs of origination is well established.

1) Absent ex ante regulation, Ofcom's approach to resolving any disputes relating to origination payments would be informed by its prior approach to determining the 080 and 0845/0870 disputes and the CAT's approach in the 08 Judgment.[64] Ofcom's analytical framework consisted of three principles, endorsed by the CAT, the first of which provided that *"The MNOs should not be denied the opportunity to recover their efficient costs of originating calls to [080/0845/0870] numbers hosted on BT's network. In the context of this Dispute, we consider that this means it is not fair and reasonable for BT to impose variable termination charges unless the average retention by each of the MNOs (which is the average retail*

[63] 2012 Consultation [16.73] and [16.213].
[64] 2012 Consultation [17.50].

price minus the termination charge) is sufficiently large relative to the retention obtained on geographic calls."

2) The CAT commented in the 08 Judgment that it considered that the ability to allow the originating CP to recover its costs to be a "*basic requirement that needs to be complied with*". The CAT's reasoning behind that was in part because it considered that the "*terminating CP has an effective monopoly*" over termination on its own network: "*an originating CP cannot make any choice as to which communications provider terminates any particular call*".[65]

113 Three considers it essential that in Ofcom's implementation of zero rating, the ability of MNOs to recover their efficient costs of origination is guaranteed. Please see Three's above response to Question 16.2 for Three's cost estimate for origination charges in this respect.

The need for certainty

114 Failure by Ofcom to provide ex ante regulatory certainty regarding adequate cost recovery by mobile OCPs will lead to a reliance on commercial negotiations between mobile OCPs and TCPs to agree the origination charges, which will almost inevitably result in disputes being referred to Ofcom by mobile OCPs.

115 Ofcom express concern that uncertainty created by reliance on the dispute regime to determine the mobile OCPs' origination payments will affect SPs, due to the potentially major change to their business.[66]

116 However, Ofcom have overlooked the obvious impact on mobile OCPs of uncertainty regarding the recovery of their origination costs. If mobile OCPs are required to apply zero rate retail charges for calls to Freephone numbers whilst still in dispute with certain TCPs and SPs as to whether their origination charges will be paid, there is a significant commercial risk to the mobile OCPs.

117 Relying on the dispute resolution regime to address the issue of recovery of efficient costs of origination would cause significant uncertainty in the short term (at least). The recent history of disputes relating to the rates for termination on NGN ranges indicates that a case by case dispute resolution process (with the prospect of appeals to the CAT and Court of Appeal) may not result in a sufficiently swift determination of the rates which are to be applied when there is disagreement between

[65] 08 Judgment at [400].
[66] 2012 Consultation at [17.54].

communications providers as to the appropriate level of the charge. OCPs have been in a position of uncertainty for a number of years in relation to the level and structure of termination rates for non-geographic numbers. Such periods of uncertainty obviously affect MNOs' ability to make informed business decisions.

118 Three agrees with Ofcom that the existing guidance as to how Ofcom may approach a dispute on origination charges if zero rating is adopted (namely the analytical framework adopted by Ofcom when determining the 080 and 0845/0870 disputes)[67] would not be sufficient to provide certainty in respect of origination payments in the event zero rating is adopted.[68]

119 However, as addressed in the next section, it remains unclear to Three precisely how much more certainty would be provided by Ofcom's proposed access condition.

IV. Ofcom's proposed access condition on TCPs

120 Three understands that Ofcom intend to further consult on the precise wording of the obligation, however we have the following initial comments on the three elements of the proposed access condition.

Purchase obligation on TCPs

121 The first part of the proposed access condition requires TCPs to "purchase wholesale origination services for calls terminating on designated free to caller ranges from any requesting OCP".

122 We note that this is effectively an obligation on OCPs to zero rate calls to Freephone ranges. As set out in response to Question 16.1 above, Three doubts whether the activities of OCPs fall within the concept of "rights of use" for the purposes of the Authorisation Directive, but that term undoubtedly encompasses the activities of TCPs/SPs. The appropriate mechanism to secure recovery by OCPs of their efficient costs of origination would be to make payment of such costs a condition of the right of use (properly understood as covering the activities of TCP/SPs to whom a number range has been allocated) for 080 and 116 numbers.

[67] 2012 Consultation at [17.51].
[68] 2012 Consultation at [17.51].

"Fair and reasonable terms and conditions"

123 The second part of the proposed access condition requires TCPs "to do so on fair and reasonable terms and conditions (including charges)".

124 Three is not convinced that this condition would provide sufficient certainty to address the problems identified above which would arise at the wholesale level in the event zero rating were implemented.

125 The 2012 Consultation does not provide Three with comfort that the access condition will operate in a way which is substantively different to the dispute resolution procedure (which Ofcom have themselves rejected as insufficient to address the concerns about certainty). Three notes that:

1) It is already well established that under the dispute resolution procedure as it stands, and in the absence of other regulation, charges must be fair and reasonable, and it is a fundamental requirement of that fairness that OCPs are able to recover their efficient costs of origination. (See Ofcom's "*Principle 1"* in the analytical framework for determining disputes in this context, and the 080 Judgment at [400]).

2) There is a real risk that the proposed access condition, imposing a requirement that TCPs purchase origination on "*fair and reasonable terms and conditions (including charges)*" would do nothing more to address the concerns about certainty than the existing dispute resolution procedure.

3) For example, at paragraphs [3.69] and [3.70] of the 2012 Consultation Ofcom refer to an existing access condition imposed on BT under s73(2) CA to "*purchase wholesale narrowband call termination services on reasonable terms and conditions (including charges) from a requesting CP*". Albeit that this relates to the purchase of call termination services, this is an existing condition which seems similar in terms to that now proposed by Ofcom. In relation to this existing access condition Ofcom themselves note, that "*as no exact rate is set under the Access Condition, termination rates for calls to these numbers are essentially determined by commercial negotiations, subject to the rate being determined by dispute should negotiations fail."* There does not seem to be much difference in substance between the position under that access condition and the position under the dispute resolution procedure set out in subparagraph 1) above.

126 Accordingly, absent detailed guidance on the precise rate which is considered fair and reasonable (or at least a method of calculation of that

rate) it is hard to see what difference in substance there would be between Ofcom's "no ex ante regulation" option and Ofcom's "ex ante access regulation" option (set out in paragraphs [17.45] – [17.54] and [17.55] – [17.69]).

1) The key difference between the two must be that under the ex ante access regulation option Ofcom can and proposes to provide guidance in advance on the meaning of what is "*fair and reasonable*".

2) Whether that guidance is sufficient to address Three's concerns about the need for certainty that it will recover its costs of origination obviously depends on the precise content of that guidance. Three notes that Ofcom will not be consulting on the precise terms of the access condition (or any accompanying guidance) before the response to this Consultation is due.

127 Three considers that in order to adequately address Three's concerns about certainty of recovery of origination costs, any guidance on the meaning of "*fair and reasonable*" must provide the following as a minimum:

1) Some form of guarantee as to the precise level of origination charge which an OCP will recover under zero rating. As set out above, the dispute resolution process already requires that OCPs can recover their efficient costs of origination. To provide greater certainty, the guidance would need to set out the exact mechanism by which a sufficient origination charge is calculated such that recovery of costs is guaranteed. Given that a mobile OCP's efficient costs of origination are estimated to be 3.0ppm, Three needs a guarantee that it would be able to recover at least that amount per minute. More generally, Three considers that guidance is needed as to the precise level of the charge (rather than a range). We understand that Ofcom envisages that there will be a single origination charge which does not vary between mobile OCPs[69]. It is highly unlikely to be feasible to achieve this by commercial negotiations. Therefore, Ofcom needs to be specific in its guidance on the precise level of the origination payments.

2) The guidance must also be sufficient to address the imbalances which exist at the wholesale level of the market. Ofcom recognise that in addition to providing certainty as to origination payments, the proposed ex ante regulation needs

[69] 2012 Consultation at [17.80]

to also "*restrict the ability to impose unreasonable terms on CPs with a relatively poor negotiating position*" (2012 Consultation at [17.64]). Three considers that it is in a relatively poor negotiating position in this respect, for the following reasons.

a) Ofcom have recognised a number of imbalances at the wholesale level in the 2012 Consultation. In Annex 10.12 Ofcom set out three factors which influence the negotiating strength of a wholesale OCP ("WOCP") or a TCP, namely (1) WOCP's accounting for a high share of wholesale call origination would likely be in a stronger position that those accounting for a low share of call origination; (2) TCPs accounting for a high share of termination would likely be in a stronger position that those accounting for a low share of termination; and (3) vertically integrated firms would likely be in a stronger position that vertically separate firms of comparable size. When those criteria are applied to the "*Taxonomy of firms active at the wholesale level*" contained in Ofcom's Table A10.2, it is clear that BT's negotiating strength stands apart from all others in the market. Added to BT's position as a transit operator, it is clear that BT will have significant power in negotiations over the rates of origination payment. Three notes that concerns about alleged abuses of BT's dominance at this level of the market have already been raised to Ofcom.[70]

b) In addition, Three considers that Ofcom must bear in mind the power given to BT by reason of the asymmetry in the SIA, described in the Annex to this response.

c) Further still, Three considers that Ofcom must also bear in mind the market power possessed by <u>all</u> TCPs when they terminate non-geographic calls. As the CAT recognised in the <u>080 Judgment</u> [71] each TCP is in the position of a monopolist when negotiating the rates for termination on its network. For that reason, amongst others, Three remains of the view that the market for

[70] See, for example, recent disputes that have been referred to Ofcom, including the Dispute between Everything Everywhere and BT regarding termination charges for 0844, 0843, 0871, 0872, 0873 and 09 number ranges (Case number CW/01088/03/12) and the Dispute relating to BT's SIA (Case number CW/01083/01/12

[71] Paragraph [400].

termination of calls to non-geographic numbers is one which is network specific, on which each TCP has a 100% market share and is therefore dominant.

d) Three urges Ofcom to ensure that these imbalances in negotiating strength at the wholesale level of the market are adequately addressed when Ofcom gives guidance on the meaning of the access condition. Three must be able to achieve a sufficient origination payment to cover its efficient costs, and Three should not be prevented from doing so by the market power of the TCPs on whose networks Three will have to terminate zero rated calls.

3) Third, the guidance will need to be in place before any entry into effect of zero rating. Absent this, Three and other MNOs will be subject to an unacceptable period of commercial uncertainty as to their ability to recover their costs of origination.

128 Three notes that Ofcom have rejected the option of a market review as a means of addressing wholesale concerns in relation to origination payments because they consider this to be too time consuming and that the proposed access condition would be a suitable remedy. For the reasons set out above, Three remains unconvinced that the access condition is in fact suitable to address the risk of uncertainty of origination payment. In the event the access condition proposed by Ofcom and any future Ofcom guidance on the meaning of "*fair and reasonable terms*" do not provide sufficient certainty to OCPs to guarantee their costs of origination without unduly frequent recourse to dispute resolution, Three expects Ofcom will be required to reconsider the need for a market review to address those concerns.

129 In any event, as noted at the outset of this response, Three considers that Ofcom ought to conduct a review of the wholesale market in the context of non-geographic calls. In particular, Three notes that:

1) Ofcom have recognised that there are problems at the wholesale level of the market, but have not attempted in this review to address them in a targeted manner.[72]

2) The CAT has recognised that TCPs are in the position of effective monopolists on their network. That dominance needs to be considered and addressed by Ofcom. There have been persistent problems at the wholesale level and only a

[72] 2012 Consultation at [4.79].

concerted review of the market power of TCPs can remedy the wholesale issues in the long term. There ought to be equality in the approach taken to termination on mobile networks and termination on non-geographic number ranges.

130 Accordingly, whilst we welcome the efforts which Ofcom is making to resolve problems in relation to non-geographic numbers, Three's overriding position is that there ought to be a review of the wholesale market. Ofcom has not taken targeted steps to deal with those problems in this review, and Three considers that the task of doing so remains to be carried out by Ofcom in future.

Timing of notifications by TCPs to SPs

131 The third part of the proposed access condition requires TCPs to "notify their SP customers of any initial revision to the charges for wholesale origination services within two months of Ofcom imposing the requirement for zero maximum prices".

132 Our first concern regarding this element of the proposed access condition relates to timing. Our understanding is that this requirement is intended by Ofcom to provide advance notice to SPs of the changes to the origination charges, particularly for mobile OCPs (paragraph [17.76]). However, this is not altogether clear from the current drafting. Three is particularly concerned that the current ambiguity of the phrase "*within two months of Ofcom imposing the requirement for zero maximum prices*" could give rise to a scenario where mobile OCPs are required to change their retail prices, but do not have certainty that their origination charges have been accepted by or will be recoverable from TCPs.

133 Three's second concern relates to the way in which such an obligation will work in practice, in light of BT's SIA. We discuss in the Annex the importance of establishing whether mobile OCPs' origination charges for 080 and 116 calls are to be classified as "*Operator Services*" or "*BT Services*" for the purposes of Paragraphs 12 and 13 of the SIA. If these charges are classed as charges for Operator Services, Paragraph 13 will apply, and pursuant to the BT's Charge Change Manual[73] (the CCSLA), Three is required to give BT 56 calendar days notice of a change in its charges for such services. Three would then expect BT to give the requisite notice to its SPs of Three's proposed origination charges. Three urges Ofcom to consider how its requirement for notice "within two months" will fit in with these contractual obligations, which we understand

[73] Drafted by BT Wholesale, Issue 2 dated 25 February 2010.

are common across the industry where BT is acting as TCP or transit operator.

Q17.2: Do you agree that the access condition does not need to be extended to OCPs, but is effectively binding on both parties? If not please give your reasons.

134 Three agrees that it is unnecessary to extend the access condition to OCPs. OCPs already have a commercial incentive to offer access to their customers. Moreover, Ofcom has presented no evidence of market failure in this regard that would require such regulatory intervention.

135 From a mobile OCP’s perspective, it is vital to have certainty that its costs of origination will be met by the TCP and ultimately, the SP. Provided that this certainty is assured by Ofcom in the ways we have identified in our response to Question 17.1 above, Three agrees the access condition on TCPs is effectively binding on both the OCP and TCP.

136 Finally, we remain of the view that it would be entirely unfair and disproportionate to require a mobile OCP to provide access to Freephone number ranges where it does not have prior agreement from the relevant TCP that its costs of origination for calls to that number range will be met through origination charges. As noted above, it is a fundamental principle of Ofcom’s analytical framework for disputes that OCPs be entitled to recover their efficient costs of origination.

Q17.3: Do you have any other comments on our proposed implementation approach for making Freephone free to caller? For example, do you consider it necessary for Ofcom to impose a requirement on SPs to publicise that 080 calls are free and do you have any other suggestions for how SPs could be encourage to publish that at the point of call? Are there any other implementation issues which need to be taken into account?

137 Yes, we believe that Ofcom needs to impose a requirement on SPs to publicise that 080 calls are free as that would increase transparency and help educate consumers about the changes to pricing of the Freephone number ranges.

Annex A Wholesale SIA concerns

BT's Standard Interconnect Agreement

138 Three is a party to a Network Charge Control Standard Interconnect Agreement with BT dated 19 August 2001 (the "SIA"). All CPs wishing to interconnect with BT must sign the SIA.

139 BT's SIA is the mechanism under which negotiation for origination payments will take place. The SIA, together with its various annexes and schedules, contains the terms and conditions on which calls between BT and Three's networks are connected. In addition to calls which originate from or terminate on Three's network and terminate on or originate from BT's network, BT acts as a transit operator in relation to calls to and from Three's network which are originated or terminated by other communications providers.

140 The terms of the SIA are an important feature of the power which BT holds in this market. Ofcom are aware of concerns expressed by a number of operators about the power which BT holds when negotiating rates for termination of calls on its network. The concern has been raised that BT is in a position of dominance when setting termination rates.[74]

141 Paragraph 12 of the SIA deals with charges for BT services or facilities. Paragraph 13 of the SIA deals with charges payable by BT to another operator. A significant imbalance exists between the rights of BT and the rights of the other contracting party under the SIA because:

1) under Paragraph 12 (relating to all BT services):

   (a) BT can unilaterally vary its charges, subject only to the Paragraph 26 dispute resolution procedure; and

   (b) other communications providers ("CPs") cannot propose changes to charges for BT's services.

2) under Paragraph 13 (relating to operator services):

   (a) A CP can propose changes in charges for its services to BT: these charges will not take effect unless BT agrees or the charges are determined by Ofcom; and

   (b) BT can also propose changes to the charges for operator services: these charges will not take effect

[74] See Everything Everywhere's dispute relating to the termination rates levied by BT under NCCNs 1101 and 1107 (CW/01088/03/12) in which Everything Everywhere sets out its view that BT is in a position of dominance when setting rates for termination.

unless the CP agrees or, in the absence of agreement, the charges are determined by Ofcom.

142 Prior to the decision of the Competition Appeal Tribunal ("CAT") in the 08 Judgment [2011] CAT 24, the dispute resolution procedure set out in paragraph 26 SIA acted as a fetter on BT's ability to unilaterally vary prices under paragraph 12 SIA. Three's understanding was that, in the event of a dispute between Three and BT regarding charge changes introduced by BT under Paragraph 12, Ofcom would assess the dispute taking into account a wide range of factors, within the context of the wider regulatory regime, thus going some way to redress the imbalance.

143 The 08 Judgment introduces a new interpretation of Paragraph 12. Attributing a previously unrecognised pre-eminence to the relevance of BT's underlying contractual rights, the Judgment requires that, in the absence of distortions of competition, Ofcom will only be able to determine that BT's new charge under Paragraph 12 is not fair and reasonable between the parties if Ofcom's welfare assessment demonstrates, "*and demonstrate[s] clearly, that the interests of consumers will be disadvantaged*" (Judgment, §448). Following the Judgment, BT has a much wider margin of discretion to vary prices and, as recognised by the CAT has a "*right to vary ... whereas paragraph 13 gives a right to propose a variation*" to other communications providers, including Three.[75]

144 The 08 Judgment aggravates the already unsatisfactory situation of asymmetry in the SIA, and exacerbates the imbalance in the relative powers of negotiation as between BT and other operators.

145 Three is in dispute with BT regarding the continued presence in the SIA of Paragraph 12 as currently drafted, in light of the interpretation given to it in the 08 Judgment. Please see Three's dispute notice relating to the SIA dated 2 February 2012 ("the SIA dispute notice"), under consideration by Ofcom under case reference CW/01083/01/12. Ofcom have recently written to Three stating that exceptional circumstances now exist that require it to postpone its determination of this dispute pending the Court of Appeal's judgment in the 08 Appeal (Cases refs: C3/2011/3121, C3/2011/3124, C3/2011/3315, C3/2011/3316 and C3/2011/0692A)[76].

[75] 08 Judgment at [438].
[76] See letter from Lawrence Knight (Ofcom) to Xavier Mooyaart (Three) dated 8 June 2012.

The characterisation of a negative charge

146 A further problem created by the current imbalance in the SIA which ought to be considered by Ofcom when implementing any decision to zero rate is that, crucially, it is possible that under certain circumstances, a charge for the same service may be issued seemingly interchangeably, under either Paragraph 12 or Paragraph 13 of the SIA.

1) The case of NCCN 911 provides an illustration, and is a useful point of comparison with the origination charges that Ofcom envisages in the Consultation for Freephone numbers.

2) NCCN 911 related to BT Freephone 0800 and 0808 calls. Prior to NCCN 911, the prices for calls to these ranges were expressed to be negative prices to be paid by operators to BT – in reality, BT paid a call origination charge to the CPs originating numbers to 080 number ranges. The situation prior to NCCN 911 could be characterised in two alternative ways, either as: i) a (positive) origination charge; or ii) a (negative) termination charge, paid by BT to the CPs.

3) In the 08 Judgment, the CAT considered that the service provided was in fact an operator service for the purposes of the SIA. The CAT's reasoning turned on the negative pricing structure, and the fact that BT would pay operators under NCCN 911 for an operator service, namely call origination.

4) BT issued NCCN 911 in 2008, pursuant to which BT withdrew the negative charges for 080 number ranges, and as a result, ceased paying any amount to the CPs for these calls. The CAT stated that "*NCCN 911 must have been Charge Change Notice under paragraph 13.3*". In fact BT proposed the change as an NCCN, and therefore under Paragraph 12.

147 As Three noted in the SIA dispute notice, it simply cannot be the case that the characterisation of a negative charge in one way or another can have such an impact on the way in which interconnection charges are imposed; and, crucially, the way in which Ofcom considers and determines a dispute.

148 Ofcom appear to envisage that the origination charges for Freephone calls will be set by the OCP, and therefore, would constitute a charge for an Operator Service under Paragraph 13 SIA. If Ofcom introduce their proposed changes to Freephone calls but neglect to provide strong guidance on which Three can rely to persuade BT to accept our origination charges, BT will have free reign to reject the prices proposed by the mobile OCPs.

149 These issues at the wholesale level of the market caused by the asymmetry in the SIA must be taken into consideration by Ofcom when considering the appropriate regulatory response to ensure that OCPs are able to recover their efficient costs of origination upon any entry into effect of zero rating.

150 Three notes that Ofcom have decided not to consider the effects of the SIA in the 2012 Consultation response (see Annex 10.108) to avoid pre-empting the determination of the SIA dispute. Three urges Ofcom to ensure that any regulatory solution at the wholesale level designed to provide certainty of origination payment takes this market reality into consideration. Three hopes that Ofcom will give appropriate consideration to the impact of the SIA on the operation in practice of the proposed access condition before any entry into effect of zero rating and in Ofcom's proposed guidance on the meaning of the requirement that charges be fair and reasonable.

Wholesale SIA concerns continued