Ofcom Consultation - Fair and Reasonable Charges for Fixed Geographic Call Termination – Published 16 September 2010

BT Response 26 November 2010

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1. Executive Summary

1.1 It is essential that there is a consistent method for determining fixed geographic termination rates in the wholesale market that can be applied fairly and reasonably across the Telecommunications Industry in the UK. As it was not possible to achieve consensus through the industry discussions initiated by BT, BT strongly supports Ofcom's initiative to produce definitive guidelines.

1.2 The UK has the most competitive telecommunications market in Europe. The wholesale market in the UK has been effectively regulated representing some of the best practice in Europe. As a result, the level of competition has grown steadily in recent years, and there is now a mature competitive market. This has been recognised by Ofcom with the recent decision to deregulate the retail markets for lines and calls. The expired reciprocity agreements had been in place since 1997, and gave CPs sufficient time to achieve the efficient termination cost levels reflected in BT's LES rate. In a mature market, asymmetry is no longer justified, and BT supports Ofcom's view that setting all CP fixed termination rates equal to BT's termination rate (currently the LES rate) - Option 3 - best meets the six criteria outlined and the interests of consumers. In addition, Option 3 best addresses industry's concern that competition is being distorted by the use of third parties and the inbound-outbound link in the expired Reciprocity Agreement, as well as removing the scope for gaming the sampling to generate higher termination rates.

1.3 It is important that Option 3 is implemented as soon as practicable to realise the benefits for the consumer and the industry, and this could be achieved by 1st October 2011 rather than 1st October 2012 proposed by Ofcom.

1.4 BT supports Ofcom's 3 policy objectives for NGNs and the preliminary conclusions on the apportionment of conversion costs. BT is willing to consider reasonable requests for access via IP Interconnect on fair and reasonable commercial terms and on the basis of NICC standards unless otherwise agreed bilaterally.

2. Section 4

Question 1 *Do you agree that this section sets out the key issues? If not, please set out any additional issues which you think we should consider in providing guidance on fair and reasonable charging for termination of calls to fixed geographic numbers.*

2.1 BT agrees that Ofcom have set out in section 4 most of the key issues that need to be addressed through the proposed guidelines. However, there are several issues BT would like to highlight to ensure the guidelines fully address our concerns and that the scope for future disputes is minimised.

2.2 Interim Arrangements - Regarding what is a fair and reasonable rate in the period between expiry of the last Reciprocity Agreement on 30th September 2009 and the commencement of a new Agreement based on the guidelines, BT acknowledges and welcomes Ofcom's (provisional) view expressed in the consultation that "arrangements based on the expired Reciprocity Agreement should continue in the interim period….." and that "unless a party's circumstances have materially changed since the expiry of the last Reciprocity Agreement, it is unlikely to be fair and reasonable to charge for fixed call termination on something other than the same basis and terms as were provided for under the expired Reciprocity Agreement". As Ofcom are aware, BT has received several Operator Charge Change Notices (OCCNs) from CPs since 30th September 2009 requesting termination rates based on different methods and principles from the expired Reciprocity Agreement.

2.3 Scope - BT supports Ofcom's view that the proposed guidelines apply to call termination as defined in the 2009 WNMR. However, the commercial negotiation of any non-SMP element of a CP's termination rate from beyond the market boundary is a possible source of future disputes. BT proposes that it would be helpful if the guidelines contained a simple statement that any such commercial negotiation for application beyond that market boundary should take account of the reciprocity principles specified in the guidelines for call termination.

2.4 Gaming the sample - It is apparent, from the data recorded by BT, that the traffic routing adopted by some CPs during the sample period was different to the traffic routing that those CPs employ outside of the sample period. It is essential that the guidelines either adopt an approach that precludes such behaviour (Option 3), or at worst include a statement that the sample is only valid if it is representative of the CP's normal usage over a 12 month period.

2.5 Symmetry of rates - Under the expired Reciprocity Agreement, option 1, CPs can route calls via a third party transit CP and as a result BT receives Local Exchange rate, but pays out a higher rate because the minutes delivered via the third party are not included in the originating CP's reciprocity calculation. This is not consistent with the fundamental principles of reciprocity and is not acceptable to BT. It would need to be addressed by the guidelines were Ofcom to adopt Option 1.

2.6 Sample Periods – In the case of Options 1 & 2, the termination rate for each CP should change in relation to each sample period. It is unacceptable for a material change in circumstance identified in a sample period not to be reflected in the termination rate until after the following sample period which was the case in the old reciprocity agreements.

2.7 Tariff periods – The BT LES rate is based on BT costs that are applied through BT tariff periods. As the CP FTRs are based on the BT LES rate and possibly other BT rates (options 1 & 2), CP tariff periods applied to CP FTRs should be aligned to the BT tariff periods used for BT termination rates.

2.8 KCOM - BT understands the additional cost-orientated obligation placed upon KCOM in the Hull Area but questions the lack of symmetry available. BT proposes that symmetry be applied to ensure reflection of the costs of an efficient operator within the KCOM Hull Area termination rate.

2.9 Correction – On a point of detail in paragraph 4.4.3 the third approach is characterised as "This rate would have been a fixed blend of BT's LES and ST rates derived from the ratio of traffic that all fixed networks sent to BT's DLEs to the total traffic that those networks sent to all BT's exchanges irrespective of their type". This is not quite correct as it would only have included the traffic sent to BT and charged by BT at either the Local Exchange or Single Tandem rates.

3. Section 5

Question 2 *Do you think we should consider other options for the general application of reciprocal charging? If so, please describe those options and your reasons as to why it is appropriate to consider them in the context of our proposed guidance.*

3.1 BT does not consider that any further options beyond the three identified in paragraph 5.6, should be considered.

3.2 Furthermore, BT would like to stress that "Do nothing", as outlined in paragraph 5.6, is not a viable solution. It is clear from the OCCNs already received by BT since the expiry of the previous Reciprocity Agreement on 30th September 2009, that the lack of guidance and the absence of agreements on a common basis across industry will result in CPs seeking ways of constructing a method of calculating a termination rate that simply best suits them and their position in the industry as either a net terminator or a net originator. It is inevitable that this situation would lead to an increase in the number of disputes and a tendency toward higher termination rates to the detriment of the consumer.

3.3 The guidelines must identify which single one of the three options outlined should be adopted universally by all CPs across industry. It would not be acceptable for more than one option to be available as this would lead to further disputes over which should be used.

3.4 The guidelines should also address how symmetry with KCOM in the Hull Area will be achieved by aligning the KCOM Hull Area termination rate with the chosen option.

Question 3 *Do you agree with our assessment of the options and provisional conclusion in favour of Option 3? If not, please explain which option you favour and why.*

3.5 Overall, BT supports Ofcom's assessment of the options and provisional conclusion in favour of Option 3.

3.6 BT strongly supports the principle of reciprocity i.e. where services are provided reciprocally, charges should also be reciprocal. Under the reciprocity agreements that expired on 30th September 2009, CPs could choose whether to interconnect at the Tandem or Local Exchange layer, thereby determining both the rate they paid and the rate they received for call termination. In contrast, BT's termination rate is determined by Ofcom based on the costs of an efficient operator, and BT cannot influence the rate it pays for call termination because that reflects the decisions made by CPs. Thus, potentially all CPs have access to call termination at Local Exchange Rate but BT does not. Whilst this may have been acceptable at a time when BT had SMP in Local to Tandem Conveyance and most interconnect took place directly at the tandem layer, it is no longer acceptable in a mature competitive market. Access to a symmetric termination rate is a fundamental requirement for BT.

3.7 The industry talks initiated by BT to put in place new agreements to replace those which expired on 30th September 2009 foundered on the so called inbound/outbound link whereby the further a CP builds out into BT's network the lower the termination rate they receive. Industry argued that this acted as a disincentive to reduce costs by building out. The development of the use of third parties to deliver traffic to BT means that BT also supports the removal of this link, because CPs can reduce their payments for call termination to BT by using a third party to deliver calls to BT's DLEs, whilst maintaining the rate they receive from BT at the ST rate in relation to the residual traffic they deliver at the tandem layer. Should they deliver NO traffic to BT directly for call termination, their rate would be ST by default under the old agreements. Meanwhile, in both cases, BT receives LES rate whilst having to pay ST rate, thereby removing the element of reciprocity. BT strongly supports the removal of the inbound/outbound link.

3.8 In its 1997 statement, Oftel noted that there tended to be a difference in network topology between BT's and CPs' networks, and this was part of the justification for CPs receiving a termination rate above LES. However, as Ofcom points out at para 5.13 of the consultation, 'whilst it may be true that a local switch in BT's competitors network often covers a greater geographic area than a typical BT DLE, in the current environment of diverse technologies and multiplicity of networks this is not necessarily a reliable indicator either of the actual costs of terminating a call in the network in question or that the costs are necessarily efficiently incurred'. For the mature call termination market in the UK to operate efficiently, CPs should no longer be able to charge more than the costs of an efficient operator – in this case BT's LES rates. BT strongly supports the three criteria proposed by Ofcom for making exceptions.

Regarding the 6 criteria

3.9 Cost Causation – It is a well established principle (as Ofcom have detailed in the consultation) that termination charges should not exceed those of an efficient operator. LES rate is the only FTR that meets this principle as a norm in the UK, and provides the appropriate incentive for efficient investment to achieve lower costs and/or greater benefits for the consumer. In the mature UK market where wholesale market competition is well developed, there is no justification for the customers of an efficient operator to continue to subsidise those of a less efficient operator by paying a higher termination rate. This is especially true as all of the planning decisions made by a terminating Fixed Network CP that affect their network and how they connect their customers to it are within that Fixed Network CP's control. This is summed up in the EC recommendation[1] where they state 'that fixed CPs have the opportunity to build their networks in particular geographic areas and to focus on high-density routes and/or rent relevant network inputs from incumbent operators. This view

[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:124:0067:0074:EN:PDF see Recital 16

implies that CPs will connect customers to their networks directly (and hence provide termination services) only where this can be more profitable than buying wholesale inputs from the incumbent – such as wholesale line rental (WLR) and wholesale call origination'.

3.10 Cost Minimisation – BT Local Exchange rate is the established proxy for the termination costs of an efficient operator in the current UK market for fixed geographic call termination and only this rate provides the appropriate incentive for others to minimise costs. All other options provide for the setting of a higher FTR and therefore allow CP's to recover costs without minimising them. It is important to stop the manipulation of rates that does not minimise costs. It is unacceptable for a CP to be able to introduce higher FTRs through manipulation of routing patterns, as has occurred to date, and allow recovery of costs that are not minimised. Both options 1 and 2 allow this to occur. Only Option 3 provides an absolute incentive to minimise costs.

3.11 Effective Competition – BT's LES rate is a stable bench mark for the cost of an efficient operator in a comparatively mature industry. The LTC market in the UK is now fully competitive, and any arrangement that permits CPs to charge a FTR higher than BT's LES rate will distort competition. The inbound/outbound link in Options 1 & 2 distorts competition. In particular, the current arrangements distort the commercial incentive CPs have to buy from third parties in preference to self build, because minutes delivered directly at the Local Exchange level attract LES rate in the X ratio, whereas minutes delivered at Local Exchange level via a third party do not count in the X ratio of the originating operator at all. Thus the X ratio of the originating operator contains a disproportionate volume of ST minutes compared to the rates received by BT. This was not the intention of the original system and current behaviours show that competition is not fully effective resulting in higher termination rates that are detrimental to the end user. It is unacceptable that a CP can manipulate their routing patterns to achieve a higher FTR that subsidises their retail offering at the expense of more efficient operators. Only Option 3 fully addresses this issue.

3.12 Reciprocity – We agree with Ofcom's presumption at para 5.34 that 'taking a technology neutral view of the service offered by the two interconnecting parties ……… the same rate should normally apply for the exchange of traffic in both directions'. Applying a non-symmetric FTR, rather than symmetry with the BT LES rate as the costs of the efficient operator, implies an acceptance of inefficient operation.

3.13 Practicability – Option 3 is not only the option that best meets the four criteria considered so far, it is also the simplest to implement. Option 1 has become distorted over the years with the development of third party interconnect and is no longer acceptable. This has meant that it is possible to distort the sample on which the rate is based by rerouting traffic during the period of sampling to generate more ST minutes. 3rd party interconnect also results in BT paying a termination rate which is not reflected by what it receives i.e. ST rate is paid out where only LES rate is received from the 3rd party as described above and effective competition is impaired. The reconciliation required to deal with these defects, as has been pointed out by industry, would add to the complexity of the billing arrangements, and in absolute terms may not be doable at all. To a lesser extent the same applies to Option 2. It is also complex, perhaps impossible, for CPs other than BT to calculate or verify volumes used to derive the X ratio used for Option 2. Neither Option 1 nor Option 2 would be acceptable to BT unless it was possible to deal with the 3rd party delivery and gaming issues.

3.14 Distribution of Benefits – There is no justification for the customers of an efficient operator subsidising the customers of a less efficient operator by paying a higher termination rate, especially given that the termination service being provided by different CPs is the same service. We have dealt with this aspect under cost causation and endorse Ofcom's proposed Option 3 as a cheaper, better, more efficient system for setting fair and reasonable FTRs in the UK market.

Question 4 *Do you agree with our proposal to adopt a framework which we would normally apply to assess claims for higher FTRs? Do you consider that the proposed 3 stage test, including, where relevant, our proposed approach to demonstrate reduced end-to-end call costs, is an appropriate and practicable approach to considering such claims? If not, please set out what approach you consider to be appropriate and why.*

3.15 BT agrees that there should be a clear and unambiguous framework defined and applied to assess claims for higher FTRs. BT also agrees in principle with the three stage test proposed to assess claims for higher FTRs but it would be helpful if the guidelines were more expansive on how the 3 stage test would work to demonstrate genuine consumer benefits overall.

Question 5 *Do you agree with our assessment of financial impacts? If not, please explain why.*

3.16 Generally, BT agrees with Ofcom's assessment of the implications for different CPs. BT would like to point out in regard to the statement made in paragraph 5.57 "this could create an artificial incentive to hand traffic over to BT at those tandem switches" that this creates a similar artificial incentive to hand traffic over to BT via a 3rd party transit CP (including another entity within the same overall business) in preference to self providing routes directly to BT's local exchanges.

Question 6 *Do you agree with our assessment of the consistency of our general proposals and our policy objectives for NGNs? If not, please explain why.*

3.17 BT supports Ofcom's view that it is desirable for a CP to levy a FTR determined independently of the technology it uses and taking account of ongoing costs. CPs have the incentive to move to NGN if it results in lower costs and this is entirely consistent with Ofcom's objectives to provide incentives for efficient investment in NGNs and to promote competition based on NGN infrastructure. There are no wider benefits that would justify manipulating the market by allowing NGN operators to charge higher termination rates where signal conversion will be required.

3.18 Ofcom's consistent approach to regulation across differing technologies, and their policy objectives offer the correct balance of providing an economic incentive to minimise costs whilst not artificially distorting commercial reward for any given technology. This is important, as to do otherwise could create market distortion whereby competition between different technological solutions would be skewed e.g. between TDM, IP, MPF, WLR, etc.

The Ofcom approach creates a market whereby investment decisions for new entrants or operators expanding their existing networks can be based upon efficient design and commerciality, thereby allowing innovation regardless of technology. The wider benefits outlined within the consultation will be realised through the delivery of solutions that best meet the needs of customers - these include feature, function, cost and quality. The investment decisions of any operator will not adversely affect the investment decisions taken by another. Operators, including BT, will only make their investments if it is the correct commercial decision for them to do so. Conversion costs form only a small part of the total cost of migration to NGN and it is unlikely that they would make a material difference to the investment decision of BT or any other operator.

Question 7 *Do you agree with our preliminary conclusion on the apportionment of conversion costs? If not, please set out your reasons for reaching a different view.*

3.19 BT supports Ofcom's conclusion on the apportionment of conversion costs and the assessment of the six principles of pricing and cost recovery. The principle of investment decisions based upon technical viability and commerciality ensures the incentive is to build efficient network solutions. These will take into account total life costs including connectivity to other communication suppliers. The decision on the technology used by an operator will therefore include the need to maintain existing interconnection and will provide the incentive for both interconnection partners to build the most efficient solution.

3.20 Interconnection at multi-service access nodes is not an efficient solution because it would be complex and expensive to administer and would result in significant wasted resources. This solution would result in a massive increase of porting prefixes and inter-working point codes, would require individual routes to each MSAN that are unlikely to be efficiently utilised, and would require a high level of management to ensure calls are routed correctly and route quality maintained. Significant re-pointing of existing ported numbers may be required at significant cost. TDM conversion equipment would be required at each MSAN location and this would be significantly less efficient than providing conversion at NGN nodes. It is likely that all calls would need to be routed to the NGN switches for routeing, charging and billing purposes. MSAN interconnection would have been incorporated already into existing network configurations if it were a viable, efficient solution. It would be unfair and unreasonable to expect the customers of TDM networks to bear the higher costs of routing to interconnect points at MSANs in an NGN that has been inefficiently designed specifically to cause other operators to incur higher costs.

Question 8 *Do you agree with our preliminary conclusion in relation to fair and reasonable FTRs in the context of TDM-NGN interconnection? If not please set out your views.*

3.21 In BT's network, where TDM interconnect is at the DLE, the regulated LES rate applies. Any requirement for conversion and call transportation between technologies (as a result of a call being sent using a technology other than TDM by the originating operator) should be considered to be additional, optional and non-mandatory.

3.22 BT will consider reasonable requests for access in the normal way taking account of the costs and forecast volumes involved. This service would be outside the market definition as it would be beyond the point nearest to the end user where signals can be exchanged. BT already offers IP Exchange Interoperability, and the principle of commerciality should prevail in the competitive market beyond the call termination market boundary. As the regulated LES termination rate only takes account of the cost of TDM interconnect directly to the DLE, the commercial rate for IP call termination on BT's own network will necessarily be higher because it will include IP-TDM conversion costs and any additional conveyance costs from the interconnect node to the DLEs in the fully competitive LTC and Inter Tandem conveyance markets.

3.23 BT concurs with the need for an agreed IP standard for NGN interconnection to be used as the basis for interconnection i.e. on the basis of NICC standards unless otherwise agreed bilaterally. This will prevent additional resource being required to manage multiple interconnect configurations which are likely to be inefficient. BT is concerned that other network operators may rely upon BT to offer interoperability between disparate implementations of protocols to avoid investment in their own resource.

4. Section 6

Question 9 *Do you think we should consider other options on timing? If so, what alternative option(s) would you propose and why?*

4.1 There are no other options Ofcom should consider. It is essential to implement on a common date across the industry to ensure consistency of charging.

Question 10 *Do you agree with our preferred option (Option 3) on timing? If not, please set out which option you prefer and why.*

4.2 BT agrees that there should be a specified adjustment period and, therefore, a specified implementation date for a new "Reciprocity" agreement to apply to all UK Fixed Network CPs, apart from BT, for geographic termination rates. The adjustment period should not be any longer than reasonably required for a CP to identify and implement routing changes for calls delivered into BT in order to optimise the impact on their business plans. Therefore, BT agrees with Ofcom's preference for Option 3 **but not with the timing of it suggested by Ofcom**. A longer than necessary period would simply be to the detriment of the consumer and the advantage of terminating CPs charging higher termination rates.

4.3 CPs who need to make adjustments will use 2Mbit/s Interconnect Links provided over existing infrastructure or Virtual Interconnect Circuits for which the lead times for the provision of new traffic routes specified within the BT Standard Interconnect Agreement (BT SIA) are 25 working days and 5 working days respectively. They are very unlikely to require routes where new transmission infrastructure has to be built and where the lead times are longer depending on the extent of the build. Therefore a reasonable adjustment period would be no more than 6 months rather than the 12-18 suggested by Ofcom. Accepting that Ofcom plan to reach their final conclusion early in the New Year, 2011. a switch to symmetric FTRs on 1st October 2011 rather than 1st October 2012 is more appropriate.

Question 11 *Do you consider that guidance on how routing constraints should be treated in the context of fair and reasonable FTRs would be beneficial? If so, please set our your views on whether it would be fair and reasonable for additional conveyance charges to be levied on those networks which are technically unable to route traffic at a more granular level.*

4.4 BT supports Ofcom's view that the proposed guidelines for fair and reasonable charges for fixed geographic call termination should apply to call termination as defined in the 2009 NBMR, and that charges for call termination from beyond the market boundary should be a matter for commercial negotiation between the parties. BT's starting position is that all traffic is delivered by BT to CPs in accordance with the agreed routing plans, with these routing plans specified at the Ofcom allocated range level. BT will only enter into negotiations where a CP can demonstrate that significant volumes of traffic have not been delivered in accordance with their number range hosting arrangements which BT could reasonably have been expected to deliver in accordance with specified/agreed routing plans. BT would only enter into negotiations if the impact on rates would make a material difference to the CP concerned. BT would expect any negotiation for application beyond the market boundary to take account of the reciprocity principles specified in the guidelines for call termination.

4.5 There are, of course, some instances where it is unavoidable to route 'incorrectly' e.g.

- Host switches not available for direct interconnection
- CP does not make capacity available for route expansion
- Dual hosting of a number range on multiple switches for traffic management purposes
- Routing to non-host switch requested by terminating CP
- Traffic to host switch too low to make direct interconnection efficient

and BT would expect the routings to be reasonable, efficient and practicable for the minutes to qualify for any negotiated rate in excess of LES rate. This is where guidance on how routing constraints should be treated in the context of fair and reasonable FTRs would be beneficial.

4.6 As outlined by Ofcom, the resource limitations of legacy (TDM) switches relating to the decoding of dialled digits are well known. The general use of Intelligent Network (IN) interrogation, for supplementing decode block resource restrictions, has also been investigated and shown not to be a viable proposition at the scale required for application to general call routing such as for geographic number ranges.

4.7 BT is in no doubt that the principle applying to the apportionment of conversion costs, stated in paragraph 5.136 of the consultation and explained through paragraphs 5.102 to 5.135, should also apply to the impact of the routing constraints of legacy (TDM) networks. It is the NGN as a terminating CP that introduces the requirement for routing differentiation at lower levels than the level at which the block has been allocated by Ofcom and does so only if that is the most efficient use of their resources. It is totally under the control of the NGN CP and totally outwith the control of the legacy network CP as to how such low level routing capability is utilised. It is unreasonable for a legacy network CP and its customers to be disadvantaged by the choices of a NGN CP to route differentially at such low levels and therefore the NGN operator should bear the cost. The guidance should take account of the same criteria used by Ofcom when deciding to allocate number blocks below the 10K level i.e. balancing the interests of all providers and consumers, bearing in mind the need to retain sufficient decode capacity to route efficiently.

4.8 Enabling a NGN CP to charge a higher FTR as a result of dispersing numbers within a single allocation across multiple different network elements would provide a perverse incentive to allocate numbers in this way simply to increase their termination rate. BT has already experienced this behaviour by one CP, and it is essential that such manipulation of rates is specifically prohibited in the guidance because it is detrimental to the interests of the overwhelming majority of customers.

END