MCT Review: 2nd consultation Stakeholder workshop

Hosted by Ofcom
5 May 2010

Agenda - outline for the workshop

Topic	Timing	Session lead
Arrival and coffee	2.00 – 2.15	-
Workshop aims and introductions	2.15 – 2.30	David Stewart, Andrea Coscelli
The MCT Consultation: Market definition, SMP & remedies	2.30 – 3.25	Chris Handley
The MCT Consultation: Charge control levels		James Mackley
Out of scope of the consultation: range blocking, number porting etc		Paul Jacobus
How to respond to the consultation	3.25 – 3.30	Paul Jacobus
Q&As	3.30 – 4.00	-

Ofcom attendees for MCT stakeholder workshop

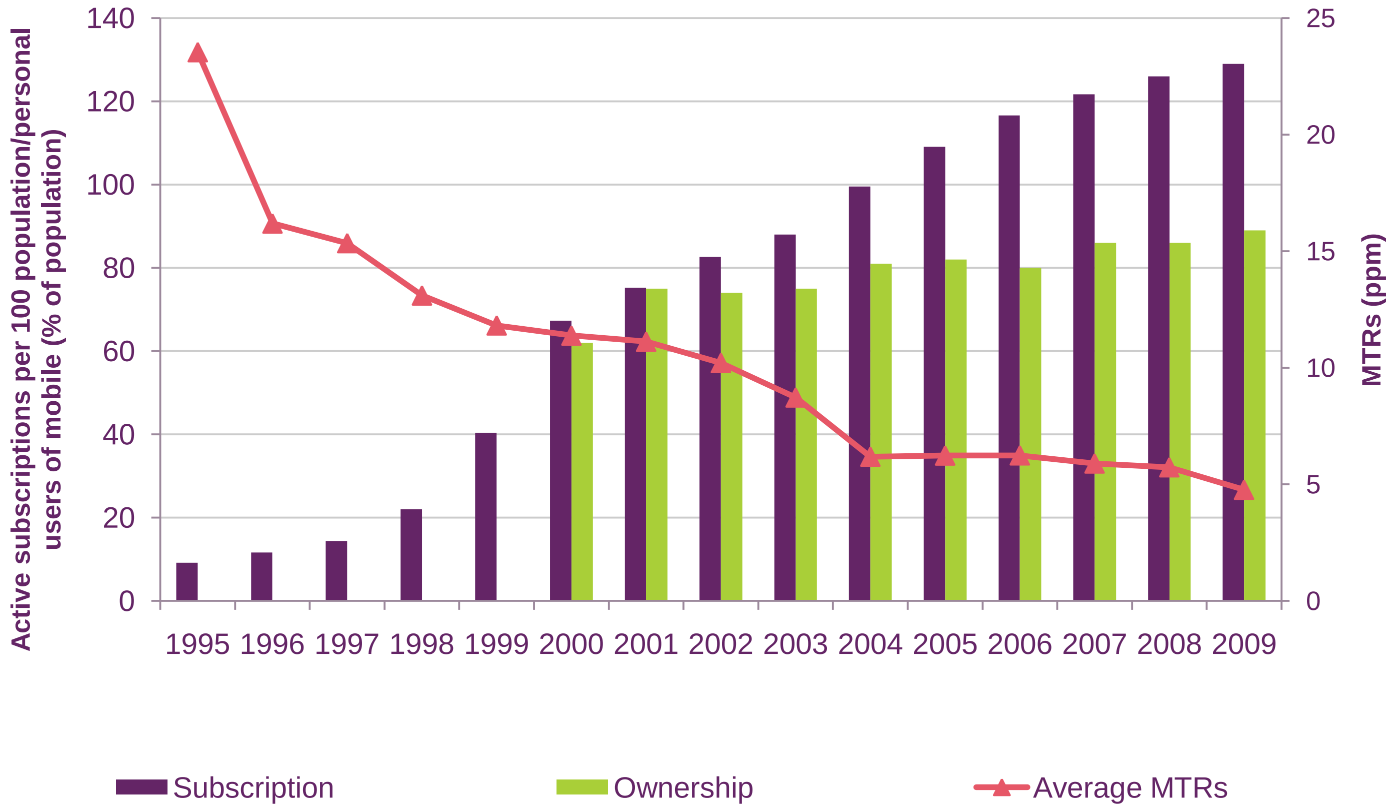
Name	Role
David Stewart	Project Director
Andrea Coscelli	Economics Director
Paul Jacobus	Project Manager
James Mackley	Economics Manager
Chris Handley	Competition Policy Manager

Why have a workshop?

- To ensure that smaller, and newer mobile communication providers understand our proposals, and the impact they could have on termination revenue.
- To help us understand the point of view of new players in the mobile market and help smaller MCPs to respond to this consultation, recognising that many smaller MCPs may not have a dedicated regulatory team.
- To make the team available to the workshop participants to help answer any questions about our proposals or what happens next.

Regulation of MTRs has a long history…

Historical MTRs, subscription and ownership



Source: Ofcom, 2009

… focused on large national mobile network operators.

Timeline of regulation 1985 - 2009

1985 · 1990 · 1995 · 2000 · 2005 · 2007 · 2009

1986
Vodafone (Racal) and O2 (Cellnet) enter the market

1991
Oftel determines MCT charge in response to request from Mercury

1993
One2One (TMO) enters

1994
Orange enters

1996
Review of BT's retail prices, concern on price of calls to mobile

1997
Consultation on MCT Oftel recommends uniform charge on all 4 MNOS

1998
Oftel refers dispute to MMC, who propose a reduction in charges for VF and O2. TMO and Orange unregulated but reduce prices

2001
Oftel conducts second review of MCT.

2003
H3G enters with first 3G network
CC recommends immediate cut of MCT charges
incoming regulatory framework required a full market review

2004
Full market review of MCT. All MNOs judged to have SMP, but charge control only imposed on four 2G incumbents

2007
Conclusion of fourth MCT review . All MNOs judged to have SMP and charge controls applied to all

2007
Ofcom conclusions in 2007 MCT Statement appealed

2009
Ofcom issues final Statement following CAT's decision

Our proposals mean significant changes:

2007 regime

- Only large players regulated
- Regulated rates currently ~5ppm
- Higher rates for smaller players

2011 regime (proposed)

- All players with mobile numbers regulated
- Rates falling to 0.5ppm by 2014
- Fair and reasonable rates for smaller players – which we expect to be the same across the market

Agenda - outline for the workshop

Topic	Timing	Session lead
Arrival and coffee	2.00 – 2.15	-
Workshop aims and introductions	2.15 – 2.30	David Stewart, Andrea Coscelli
The MCT Consultation: Market definition, SMP & remedies	**2.30 – 3.25**	**Chris Handley**
The MCT Consultation: Charge control levels		James Mackley
Out of scope of the consultation: range blocking, number porting etc		Paul Jacobus
How to respond to the consultation	3.25 – 3.30	Paul Jacobus
Q&As	3.30 – 4.00	-

Three key elements comprise a market review

Defining markets, assessing market power and proposing remedies

More markets defined in the review	Individual SMP determinations	Remedies to tackle SMP findings
Previously regulation only applied to the ‘big 5’ (now 4) Adopt a wholesale voice MCT market definition centred on mobile number range holders (07XX).	Designate all 50+ MCPs as having SMP. Notify each of them in a draft determination.	Charge control applied to national mobile CPs. Others to provide MCT on fair and reasonable terms

BT's price list highlights the wide range of current MTRs

Mobile Communications Provider	MTR (ppp) Daytime	Evening	Weekend	Weighted average charge*	Charge relative to average nominal TAC (09/10)**	Effective from
24 Seven Communications Ltd	10.0	10.0	10.0	10.0	206%	01/06/09
Cable & Wireless plc	7.6	5.4	4.4	6.3	129%	31/07/08
Callax Ltd (Jedillon Grant Ltd)	12.0	8.0	4.0	9.1	188%	
CFL Communications Ltd	12.0	8.0	4.0	9.1	188%	13/11/08
Cheers International Sales Ltd	12.0	8.0	4.0	9.1	188%	19/03/09
Citrus Telecommunications Ltd	12.0	8.0	4.0	9.1	188%	03/04/07
Coralbridge Ltd (Telephony Service Ltd)	10.0	10.0	10.0	10.0	206%	13/05/09
Core Communications Services Ltd	9.6	9.6	1.38 to 9.6	1.38 to 9.6	28% to 198%	01/06/07
Core Telecom Ltd	10.0	10.0	10.0	10.0	206%	17/09/09
D2See Ltd (Orca Digital Ltd)	6.0	6.2	6.4	6.2	127%	17/06/08
FleXtel Ltd	9.1	8.2	2.5	7.4	152%	13/07/06
Invomo Ltd	6.0	6.2	6.4	6.2	127%	17/06/08
IV Response Ltd	7.6	5.4	4.4	6.3	129%	03/05/07
Magrethea Telecommunications Ltd	8.9	6.3	4.3	7.1	147%	23/05/06
Mars Communications Ltd	12.0	8.0	4.0	9.1	188%	17/06/08
Mundio Mobile Ltd	7.2	7.2	7.2	7.2	149%	23/09/08
Opal Telecom Ltd	9.1	4.0	4.0	6.5	134%	01/09/06
Oxygen8 Communications UK Ltd	12.0	8.0	4.0	9.1	188%	05/11/09
QX Telecom Ltd	12.0	8.0	4.0	9.1	188%	11/02/08
Resillent Networks plc	7.6	5.5	4.0	6.2	128%	05/09/08
Sky Telecom Ltd	12.0	8.0	4.0	6.3	129%	01/09/06
Subhan Universal Ltd	7.6	5.4	4.4	9.1	188%	20/02/08
Swiftnet Ltd	6.0 to 10.0	6.2 to 10.0	6.4 to 10.0	6.18 to 10	127% to 206%	04/12/08
Switch Services Ltd	12.0	8.0	4.0	9.1	188%	12/01/09
Teledesign plc (Cable & Wireless UK)	7.6	5.4	4.4	6.3	129%	31/07/08
Telephony Services Ltd	6.0	6.2	6.4	6.2	127%	13/05/09
Telswitch Ltd	10.0	10.0	10.0	10.0	206%	01/05/09
Teleware plc (Jedillon Grant Ltd)	12.0	8.0	4.0	9.1	188%	16/04/08
Titanium Ltd	8.3	8.3	5.1	7.6	157%	26/04/06
Vectone Network Ltd	8.3	8.3	5.1	7.6	157%	11/05/07
Wire9 Telecom plc (Cloud9 Mobile Communications plc)	11.0	8.7	3.1	8.6	177%	01/11/06
Yim Siam Telecom Ltd (Core Telecom Ltd)	10.0 to 12.0	8.0 to 10.0	4.0 to 10.0	9.1 to 10	188% to 206%	23/07/07

Proposed view on market definition

"termination services that are provided by [named mobile communications provider] (MCP) to another communications provider, for the termination of voice calls to UK mobile numbers that MCP has been allocated by Ofcom in the area served by the MCP and for which MCP is able to set the termination rate".

Covers all allocated numbers in 07X range of MCP

Covers all voice traffic

Over all network footprint (incl natl roaming)

If you set the MTR, the rules apply

This market definition implies:

- **Technology neutral**
  - Allows future-proofing and minimizes need for ex-post intervention
- **Recognises commercial reality** that MTRs set for specific number ranges in billing systems
  - Minimizes compliance issues
- **Provides regulatory certainty** and may help reduce/eliminate disputes between new/old MCPs

Implications of proposed market definition

All calls made to a UK mobile number now included

Type of call	2007 market review	Proposed 2011 market review
Voice calls	Terminated on mobile network only	Terminated to a mobile number
Off-net [1]	✓	✓
Ported-in	✓	X
Ported-out	X	✓
Calls to voicemail	X	✓
Voice calls to mobile terminating on IP	X	✓
National roaming [2]	✓	✓
Call forward (including international)	X	✓

(1) DECT guard band MCPs (C&W, Colt and MCOM), femtocells and picocells may have been captured by the market defined in 2007 had they been operational technologies at the time.
(2) e.g. H3G or C&W using 2G MNO's network for full UK coverage

Summary of our SMP assessment

- We propose that each MCP holds a position of SMP in the market for terminating voice calls over the number ranges it controls, given that:
  - each MCP has 100% market share in the market for wholesale termination that it supplies to other operators;
  - we do not foresee any changes to the current CPP arrangements or the introduction of new technologies that will allow another provider to compete effectively in providing termination other than the MCP in question;
  - we do not believe that most fixed/mobile originating operators are able to exercise sufficient counter veiling buyer power (CBP) to overcome the terminating providers position of SMP – though we would welcome your views on the possibility of CBP; and
  - the price evidence we have does not appear to undermine our conclusions.

Applying appropriate and proportionate remedies

- Recognising that SMP remedies need to be proportionate, we do not propose to apply a charge control to all SMP-designated MCPs. Instead, we propose to take an approach that includes three elements:
  - a charge control imposed directly on the four national MCPs;
  - an obligation on all mobile number range holders to provide wholesale voice call termination on fair and reasonable terms and to publish the terms on which they provide termination; and
  - a clear signal that we would expect, as a starting point, fair and reasonable MCT charges to be at the same level as those set for the four national MNOs, though any dispute referred to Ofcom would be considered on the basis of the facts of the individual case.

Agenda - outline for the workshop

Topic	Timing	Session lead
Arrival and coffee	2.00 – 2.15	-
Workshop aims and introductions	2.15 – 2.30	David Stewart, Andrea Coscelli
The MCT Consultation: Market definition, SMP & remedies		Chris Handley
The MCT Consultation: Charge control levels	**2.30 – 3.25**	**James Mackley**
Out of scope of the consultation: range blocking, number porting etc		Paul Jacobus
How to respond to the consultation	3.25 – 3.30	Paul Jacobus
Q&As	3.30 – 4.00	-

In establishing a regulated charge level we follow set principles

- Set an **efficient benchmark** for the purposes of regulating mobile voice call termination rates

- **Competitive neutrality**: in establishing this benchmark a technology and operator neutral approach is appropriate
  – adoption of a theoretical construct referred to as the **"average efficient operator"** approach
  – not sought to replicate every detail of a MCP's business (e.g. it is not appropriate to take account of individual business strategies)

- **Proportionality**: the focus of the models is on
  – the voice call termination service…
  – …in 2014/15
  and therefore the focus of modelling issues are those that have a material impact on this key output

Key argument concerns the cost standard used in deciding the charge control level

Pure LRIC and LRIC+

- Long-run incremental cost (LRIC) is a method of understanding the incremental cost to an operator for providing a service, compared with not providing that service.
  - LRIC+ includes an allocation for the fixed and common costs for the service,
  - Pure LRIC only allows for long run variable costs to be recovered, and excludes common costs.

- Little industry or consumer appetite for a wider regulatory debate on call termination, or for radical reform moving away from the current cost-based approach in response to the 1st consultation.

- We agree with the majority of respondents to our initial consultation that the options of de-regulation, capacity-based charging, reciprocity with fixed and bill-and-keep are not appropriate approaches for the market review at this time, thought they may be in the future.

Larger MCPs’ and BT’s perspectives on LRIC+ and pure LRIC

2G/3G MNOs are strongly in favour of continuity and LRIC+

Their main arguments in favour:

- It is the status quo, well-understood and reliable with a proven track-record
- Given status quo, any change in direction needs a robust justification
- It efficiently allocates costs
- It mimics a competitive price
- Provides a stable basis for investment (they claim pure LRIC would not allow sufficient cost recovery)
- MTRs above marginal cost prevent negative distributional impacts on the subscription side of the market

BT and H3G are in favour of lower MTRs and hence pure LRIC approach

Their main arguments in favour:

- Allows overall welfare gains
- Better efficiency gains - allow common cost recovery from retail side
- Reduce the differential between fixed and mobile
- Reduce/remove mobile on/off-net differentials
- Better innovation and investment incentives

We propose to adopt pure LRIC

- The European Commission has issued a recommendation to all European regulator that states that we should use 'pure LRIC' to set MTRs.

- There are economic arguments to support both pure LRIC and LRIC+, however no one argument, or set of arguments, are sufficiently strong to give an unequivocal answer although on balance, evidence is marginally in favour of pure LRIC approach
  – The UK MCT market(s) are not sufficiently different from others in the EU to diverge from EC Recommendation

- **In general lower MTRs (and pure LRIC in particular):**
  – are more reflective of network cost structures;
  – lessen incentives to differentiate between on/off-net calls
  – are likely to increase output (calls per person) as call charges decline.

- **However implementing pure LRIC:**
  – is a marginally better solution, not the perfect solution – as there is not perfectly inelastic demand for subscriptions.

Illustrative table of charge control proposals (2008/09 prices)

Illustrative table of ppm charge control proposals in 2008/09 prices (brackets show (€c) prices)

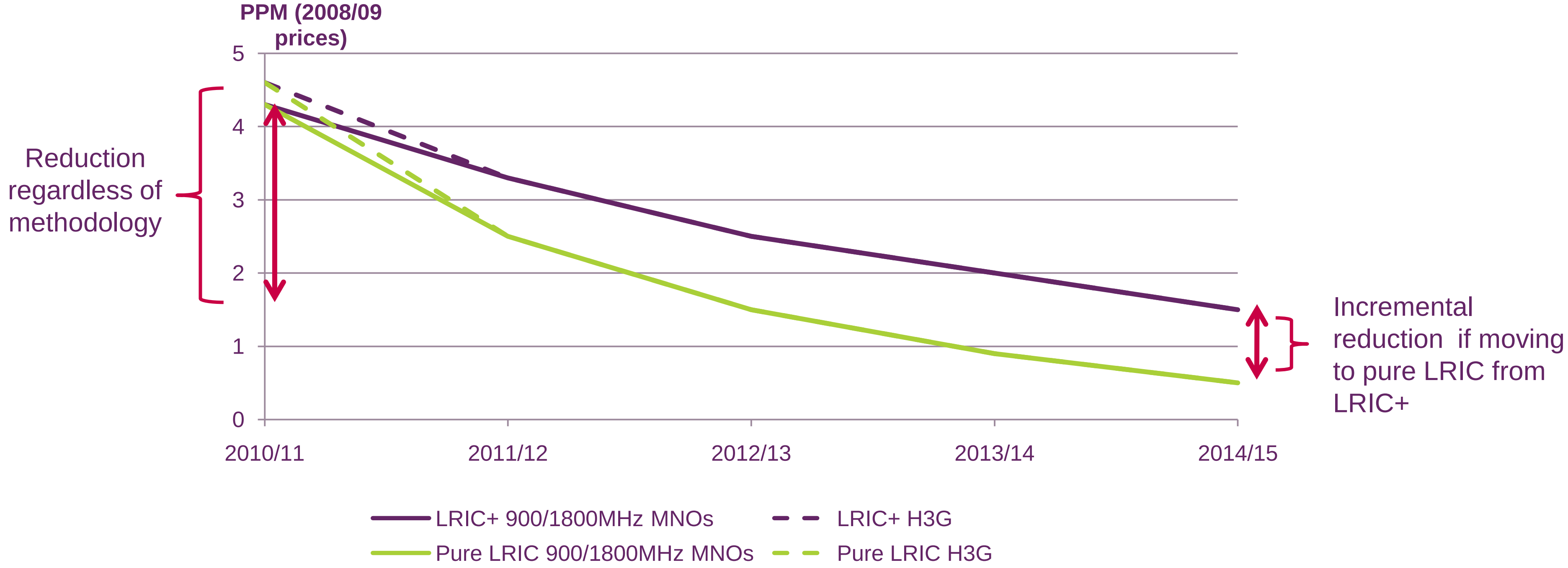
	Target charge 2010/11	%reduction 2011/12 – 2014/15 (real terms)	Final charge in 2014/15 (2008/09 prices)	X value for yearly RPI-X formulation
2G/3G national operators	4.3 (4.7)	-88.4%	0.5 (0.55)	42.7%
H3G	4.6 (5.1)	-89.1%	0.5 (0.55)	46.5%

It should be noted that the X in the RPI-X formulation will not be exactly equal to the real yearly percentage reduction. When prices are stated in nominal terms, inflation must be accounted for and is treated as a geometric term. In the RPI-X formulation inflation is treated as an arithmetic term. A geometric adjustment must be made to the real yearly percentage change. X in the RPI-X formulation is equal to the real yearly percentage change multiplied by (1+RPI).

MTRs would decline regardless of the cost standard for the final year target

LRIC+ yearly percentage change in charge : -24%
H3G year 1 decrease to align charges: -29%

Pure LRIC yearly percentage change in charge: -43%
H3G year 1 decrease to align charges: -47%



- Significant decline in MTRs due to 3G networks reaching full scale; significant data usage and greater voice usage.

Key drivers behind decline in MTRs

- LRIC+ Drivers
  - The main drivers in the change of unit cost for LRIC+ are the increase in data volumes and the updated cost for network equipment.
  - Changes in the value of the WACC and spectrum cause a small but significant change in the unit cost of termination. Although we are using a lower value for 2.1GHz spectrum, we are also using a higher value for 1800MHz spectrum. The net effect of our change in spectrum value is an increase in the unit cost of termination.

- Pure LRIC Drivers
  - The main driver in the change of unit cost under pure LRIC is the removal of common costs.
  - Changes in all other inputs have a small impact on the unit cost
  - Under pure LRIC the effect of the change in WACC would not be enough to change the base case unit cost after rounding.

Agenda - outline for the workshop

Topic	Timing	Session lead
Arrival and coffee	2.00 – 2.15	-
Workshop aims and introductions	2.15 – 2.30	David Stewart, Andrea Coscelli
The MCT Consultation: Market definition, SMP & remedies	**2.30 – 3.25**	Chris Handley
The MCT Consultation: Charge control levels		James Mackley
Out of scope of the consultation: range blocking, number porting etc		**Paul Jacobus**
How to respond to the consultation	3.25 – 3.30	Paul Jacobus
Q&As	3.30 – 4.00	-

Possible effects of lower termination rates on consumers

- **A reduction in mobile termination rates is likely to impact on the level and structure of existing mobile tariffs**
  - lower charges may increase retail pricing flexibility, and for example, make it easier for fixed operators to include mobile calls in fixed tariff bundles
  - However some re-balancing of tariffs may happen as operators seek to recover revenues, for example subscription charges (rather than per minute charges) may increase.

- **Stakeholders have provided mixed responses on this issue in response to the 1st consultation**
  - Vodafone, O2, Orange and T-Mobile argue that a reduction in termination rates will lead to tariff rebalancing, with increases in lower tariffs likely
  - Tesco Mobile make similar points, arguing that low users and pre-pay consumers are likely to face price increases
  - Conversely Terminate The Rate, H3G, BT and Asda Mobile argue that reduced termination rates will increase retail price flexibility and allow them to offer a broader range of tariffs and bundles.

Anticipated impacts on smaller MCPs

- First, MTRs paid by larger MCPs to smaller MCPs and vice versa will be subject to symmetry
- Second, these rates will fall, rapidly over the period of the control
- Third, we are tidying up other aspects of termination regulation that have caused issues (flip-flopping) etc.

- The current regime expires on 31 March 2011, therefore we expect the new regime to start on 1 April 2011; however the exact date of implementation is subject to the conclusion of this review

Three MTR disputes between large and smaller MCPs

Stour Marine dispute ongoing

- During 2009/10, we set MTRs between:
  - Mapesbury Communications Limited (MCom) and T-Mobile, and
  - Cable & Wireless plc (C&W) and T-Mobile.
- Dispute arose over the MTR to be charged for terminating calls from T-Mo to the other network.
- Both MCom and C&W are operators with respect to whom no SMP determination had been made at that time in relation to their mobile services; in the 2007 Statement T-Mobile was determined to have SMP.
- In both cases we set rates at the lowest regulated MTR (i.e Vodafone / O2 rates) between each of MCom and C&W, and T-Mobile (symmetry)

- These reciprocal rates are below the level MCom and C&W wanted to charge T-Mobile (7.2 pence per minute (ppm) and 6.418 ppm respectively.
- We estimated that costs could be between 2.9 to 3.4ppm for MCom and 2.61 to 4.14ppm for C&W
- We thought that the appropriate benchmark rate should be the rates applied to 2G/3G operators under the charge controls

Out of scope, but being monitored by Ofcom

- **Number Porting.** A consultation was published on the same day as the MCT consultation. In it we note that we propose to retain the current donor-led arrangements but reduce the time taken to port numbers to one working day and require PACs to be issued either immediately over the phone or by SMS within two hours. This is still open for responses.

- **SMS termination rates** We consider short message service (SMS) to be only a limited substitute for calling a mobile at the retail level; it does not act as a competitive constraint at the wholesale level. For that reason we do not consider wholesale SMS termination to be in the same market as wholesale voice call termination. We have not reviewed wholesale SMS termination in this review, and make no proposals in this consultation to regulate SMS termination.

- **Number blocking:** We are aware of the risk of not having end-to-end connectivity among operators, since blocking particular number ranges would mean that, even if call termination to those number ranges was available on a transit basis via BT, exclusion from the retail market might still be a concern. Consumers would be affected by the strategic refusal by larger MCPs to allow their own customers to reach the customers of the smaller MCP, making that smaller MCP's services less attractive. We have only regulated BT to date and continue to monitor the issue.

Agenda - outline for the workshop

Topic	Timing	Session lead
Arrival and coffee	2.00 – 2.15	-
Workshop aims and introductions	2.15 – 2.30	David Stewart
The MCT Consultation: Market definition, SMP & remedies	2.30 – 3.25	David Stewart
The MCT Consultation: Charge control levels		Andrea Coscelli
Historical disputes		David Stewart
Out of scope of the consultation: range blocking, MNP etc		David Stewart
How to respond to the consultation	3.25 – 3.30	**Andrea Coscelli**
Q&As	3.30 – 4.00	-

MCT Review timeline

Q2, 2009 — *20 May:* MCT preliminary condoc published

Q3, 2009 — *7July:* NRA workshop
20 July: Smaller MCPs workshop
July: S135 information request to MCPs
Sept: Bilateral meetings with MCPs

Q4, 2009 — *26 Oct:* Cost Modeling workshop
Oct: S135s to national MCPs

Q2, 2010 — *01 April :* Second consultation published

Q2, 2010 — *05 May:* Smaller MCPs workshop

Q2, 2010 — *23 June:* Stakeholder response deadline

Q4, 2010 — *Q4 (TBC)* Final statement published

Q1, 2011 — *April* 2011: New regime implemented