EVERYTHING EVERYWHERE

RESPONSE TO OFCOM WHOLESALE MOBILE VOICE CALL TERMINATION

Everything Everywhere

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1 EXECUTIVE SUMMARY

- The UK is the least profitable mobile market in the EU and the introduction of Ofcom's current proposal to reduce mobile termination rates based on "pure LRIC" risks further eroding the return to industry, deterring future network and product investment and having an adverse impact on consumers.
- Everything Everywhere Limited strongly believes that a move to pure LRIC is wrong from both a legal and an economic perspective. Pure LRIC would harm, rather than promote, competition and the interests of consumers and therefore fails to meet Ofcom's statutory duties. The low income PAYG market segment would be particularly adversely impacted.
- Ofcom has not conducted an adequate legal and economic impact assessment to properly consider the impact on consumers of its proposals. Ofcom's proposed adoption of pure LRIC is based on a number of fundamental assumptions that are not supported by the evidence.
- Everything Everywhere Limited is concerned that Ofcom's cost model does not adequately reflect the market evidence and requires major adjustment.
- Everything Everywhere Limited believes that the evidence strongly supports the retention of the existing application of LRIC+. An investigation of the evidence shows that there is no compelling reason for a switch to pure LRIC but that doing so would carry serious risks of harm to competition in the communications market and to all consumers

1.1 Introduction and market context

1. This response is being submitted on behalf of Orange and T-Mobile – the two brands which will operate under one company, Everything Everywhere Limited (referred to as Everything Everywhere), from 1 July 2010. Everything Everywhere is a 50 / 50 joint venture between France Telecom and Deutsche Telekom.

2. Everything Everywhere was formed as a response to the intensely competitive nature of the UK telecommunications market. Over a number of years, return on capital employed from the UK businesses of both companies has failed to cover the cost of capital. As a consequence of this, it was not possible either for T-Mobile or Orange to continue as independent companies, either in the short term, or in terms of securing future funding from their parents to ensure long term investment in a viable competitive offering. The future sees increasing margin pressure for UK mobile network operators significantly impacting our ability to compete with unregulated competitors and to meet the requirement for further investment in new services, technologies and

infrastructure. Wholesale revenues are also expected to fall under a continuation of the existing basis of voice call termination.

3. The vision for Everything Everywhere is simple:

   'to give people instant access to everything everywhere, opening up endless possibilities for our customers and our business.'

4. Achievement of this vision will be adversely affected by Ofcom's proposals as set out in its consultation document 'Wholesale Mobile Voice Call Termination'[1]. Coupled with exponential data growth, our customers continue to demand a reliable voice service. Voice continues to be the major source of revenue for UK mobile operators which is reflected in the substantial undertaking to refresh our 2G network. Ofcom's proposals would significantly cut operators' voice revenues with the risk that returns will be pushed further below the cost of capital.

5. Rapid future growth of the data market cannot be relied upon to compensate for the loss in termination revenues as margins in the data market are already tight. We are concerned that Ofcom's cost model currently allocates too much cost to data services and not enough to voice. This results in LRIC+ termination costs that are too low. Ofcom's cost allocation methods do not correspond with the market evidence and require major adjustment.

6. Operators are approaching spectrum and network constraints. Hence to enable operators to offer the services that customers want to use, all operators will need to invest in additional spectrum and technologies, such as LTE (which are beyond the scope of the cost model). Such substantial investment can only be expected to take place if operators are confident that they will be able to earn adequate returns on their existing investments as well as any new investments. Further it is not clear that Ofcom's demand volumes are consistent with the available spectral capacity. The ROCE for the Orange and T-Mobile businesses (which are dominated by voice services) have been below Ofcom's WACC over the last three years, which demonstrates a fundamental economic imbalance. Ofcom's proposals will have adverse impacts on these returns and push them even further below the WACC.

7. Each of the mobile networks operating in the UK is part of substantial businesses with significant operations in other countries. As a consequence, the UK market competes with other national markets for a share of investment. UK consumers will ultimately be harmed if the international operator groups limit further investment in the UK and if increases in retail pricing limit the take-up of new services.

[1] http://www.ofcom.org.uk/consult/condocs/wmctr/wmvct_consultation.pdf

1.2 Ofcom's proposal's would harm consumers

8. In its consultation, Ofcom proposes to move away from its established methodology (LRIC+) to calculate the appropriate regulated charge for mobile call termination using a new methodology (pure LRIC). The most significant impact of this change is that fixed and common costs would need to be recovered from the retail side of the market, and not the wholesale charges for the mobile termination service. Ofcom's proposed methodology gives a mobile call termination (MCT) charge of 0.5ppm in 2014/ 15, a reduction of 80% from the current regulated rate.

9. We estimate that Ofcom's proposals would directly [✂]. The majority of Everything Everywhere impact results from the PAYG part of the business.

10. Everything Everywhere is extremely concerned by Ofcom's proposals. As a matter of economics it is efficient to recover costs from the services which generate such costs. We consider that Ofcom's proposals will cause significant harm to consumers as operators will be forced to (i) attempt to recover the lost termination revenues inefficiently through other charges (as set out below); and/or (ii) reduce investment (as set out at section 1.3 below).

11. Ofcom has not thought through in sufficient detail its suggestion of a new mandatory social tariff to retain the affected consumers. Given the significant number of customers at risk, such a highly interventionist approach is unlikely to be as efficient as retaining the current arrangements. Far from "light touch regulation", this is regulation spiralling out of control with a new regulatory scheme being proposed to deal with problems created by a regulatory approach that should never have been implemented in the first place. Given the competitiveness of the mobile market such heavy regulation is clearly disproportionate.

12. As part of its consultation process, Ofcom has completed a welfare distribution analysis to consider the potential impacts of lower MTRs and states that it does not believe that '*lower MTRs will have a disproportionately negative impact on particular groups*'.[2] Our evidence does not support Ofcom's view as we demonstrate below.

13. Ofcom's proposals would impact disproportionately the PAYG segment because termination revenues are critical to the economics of providing services to PAYG customers. This segment has the highest number of low income citizens who make few outgoing calls. Amongst people with the lowest

[2] Distributional Analysis, Annex 13, A13.3

incomes (i.e. less than £11,500), 81% are reliant on prepay phones.[3] Over [✂]

14. [✂]

15. The large impact of Ofcom's proposals would leave Everything Everywhere with no option but to recover the common costs of call termination from the retail market. The measures being considered include: charging for incoming calls (similar to US model), increasing call prices, charging higher upfront fees, introducing daily charges, introducing expiry dates for PAYG vouchers / reducing the time before vouchers expire and reducing handset subsidies.

16. Such changes would however have a significant impact on PAYG consumers. Market research suggests that around a quarter of PAYG consumers would disconnect their PAYG phone if they were charged either 3 pence per minute to receive calls or an additional 5 pence per minute for outbound calls. A higher number would disconnect faced with a minimum daily charge of 15 pence per day for each day they used the phone.[4] The impact of Ofcom's proposals is therefore likely to be a reduction in PAYG consumers over the charge control period.

17. Further, The UK has a very competitive service provider and MVNO market. In Q3 2009, nine MVNOs were supplying 7.5 million consumers[5]. New MVNOs are being launched in the UK on an ongoing basis – [✂]. Many of the UK's service providers and MVNOs target PAYG or lower income consumers; hence they will see the same large financial impact as MNOs' PAYG businesses. Ofcom's proposals therefore carry a serious risk of greatly damaging the MVNO sector and therefore their contribution to competition in the mobile market.

1.3 Ofcom's proposals would set charges well below efficient costs and would harm investment and competition

18. The adoption of pure LRIC would represent the abandonment of established principles of efficient pricing and, in addition, conflicts with statements made by Ofcom and the Competition Commission on which mobile operator investment decisions have been made.

19. LRIC+, Ofcom's current methodology, on the other hand is consistent with efficient cost recovery, and has been endorsed by the Competition

[3] Ofcom, The Consumer Experience, 2008, Figure 26.
[4] Source: Market research commissioned by Orange and undertaken by GfK, June 2010
[5] Source: Informa European MVNO subscriptions for Q3 2009 (issued Feb 2010), data relates to Asda, BT Mobile, Carphone Warehouse, Gamma Telecom, IDT Telecom, Lycamobile, Tesco Mobile and Toucan Mobile

Commission following in-depth inquiries in 2003 and 2009[6]. LRIC+ allows for the efficient recovery of fixed and common costs (including spectrum, coverage and administrative costs), enabling continued investment in mobile networks for the long term benefit of consumers.

20. The current development of the market is based on established retail pricing models. Ofcom's cost model produces an extremely low calculated cost for voice services by assuming that a disproportionate share of costs can be recovered from data services. The reallocation of costs contained within the new cost model would imply that efficient prices for mobile data services are an order of magnitude higher than retail prices. The extent of this misallocation of costs represents a serious error by Ofcom, and suggests that its cost model is not fit for purpose in its current form.

21. Ofcom has also erred in setting the WACC - a key determinant of the proposed MTRs. First, Ofcom's new WACC is too low. Second, a new step-change in the WACC series distorts the recovery of costs in the model, leading to implausible results. Everything Everywhere therefore proposes a more stable WACC time series that allows Ofcom to use its market observations, without corrupting the model output in the process. We believe that Ofcom should consult on a revised approach to the WACC that addressing this serious flaw in its current approach.

22. With the implementation of the appropriate methodology and data sets, Everything Everywhere believes that the appropriate mobile voice call termination rate should be based on LRIC+ and [✂].[7]

23. Ofcom's proposals to largely eliminate a key revenue source for operators will lead to substantial market disruption with the risk that industry returns fall even further below the cost of capital, that investments in new services are delayed or curtailed and will encourage further consolidation in the market.

24. Ofcom recognises that significant cost differences between fixed and mobile technology should be reflected in different levels of charge controls. However, Ofcom unaccountably fails to accept that different charge controls should also apply between national mobile operators and niche players that do not provide a service of equivalent cost. Ofcom's proposal to regulate all players with a mobile number range at the same level results in unnecessarily high prices for consumers to call niche players and will distort competition in the overall market.

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[6] Competition Commission, Calls to mobile inquiry (2003) and Mobile phone wholesale voice termination charges – Determination (2009).
[7] Detailed discussion in section 4.

1.4 Ofcom has not complied with its legal duties or completed a proper impact assessment

25. Everything Everywhere believes that Ofcom has failed to sufficiently establish the basis of its proposal to move from the current methodology, LRIC+, to a new methodology, pure LRIC. We believe that Ofcom is basing its conclusions on the basis of unsubstantiated assumptions, and that these fundamental assumptions are wrong.

26. First, there are significant economic and competition reasons for which a move to pure LRIC will have a significant impact, and is wrong. One assumption Ofcom has made is that reductions in MTRs will be passed on to fixed consumers – however, it can be established that there is simply no evidence that this has been the case with previous reductions or that it will be in the future.[8] Further, Ofcom itself made some very robust criticisms of the draft EC Recommendation to adopt a pure LRIC model[9], and has in no way substantiated the basis on which it has chosen to ignore its previous position and to now make the very change it previously opposed.

27. Second, whilst Ofcom states there will be little overall impact on consumers, we believe that there are firm reasons and evidence to suggest that this will not be the case. [✂]

28. This is significant because Ofcom's duties require it to take into account the impact on investment, competition and consumer welfare. The implementation of a pure LRIC methodology will result in failure to allow for the recovery of fixed and common costs resulting in under recovery against investments and will require an increase in the costs recovered through retail charges. Given the structure of the UK market, the extent of prepay tariff use by the elderly and lower income groups, and the continued and increased need for fresh infrastructure investment, Ofcom's proposal to move to a pure LRIC model will have a seriously detrimental impact on citizens and consumers. Its proposal is therefore wholly inconsistent with Ofcom's statutory duties under the EU Regulatory Framework[10] and the Communications Act 2003.[11]

29. Given that (i) Ofcom provides no evidence of consumer detriment under the current model; (ii) the proposed change in the basis for and level of termination charges is significant; and (iii) the potential impact on investment, competition

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[8] Detailed discussion in section 2

[9] BERR-Ofcom comments on the draft Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU. 10 September 2008.

[10] Framework Directive (Directive 2002/21/EC), Article 8 requires Ofcom to apply objective, transparent, non-discriminatory and proportionate regulatory principles by, inter alia, 'promoting efficient investment and innovation in new and enhanced infrastructure'. See also Article 13 of the Access Directive (Directive 2002/19/EC)

[11] See e.g. sections 3(4)(d), 87(4) and 88(2) of the Communications Act 2003.

and consumers, Ofcom has provided (a) remarkably little evidence to support its case; and (b) no substantive impact assessment to substantiate its conclusions. Given the lack of a particular requirement to change its methodology, and the impact and extent of the proposed change, we believe that this too is contrary to Ofcom's duties.

30. Third, Ofcom's duties are of particular significance, not simply because they are legally binding, but because the Recommendation that it proposes to pursue is not: Ofcom must not simply comply with its duties, but it must recognise that these take precedence.[12].

31. Ofcom notes that it must take the 'utmost account' of the EC Recommendation.[13] However, this does not mean that it is legally bound to follow it. Ofcom states that 'no single argument or set of economic arguments have been found to strongly support one approach [LRIC+ or pure LRIC] over the other – both have their merits and limitations'.[14] Nevertheless, what Ofcom fails to account for is the significant differences between the UK mobile market and the considerable majority of other EU mobile markets. The UK has a fiercely competitive mobile market and already has the lowest margins and return on investment of any EU market. For Ofcom to follow a recommendation which might properly apply to operators well able to cover their common costs elsewhere is to abjectly fail to take account of the circumstances of the UK, and the level of competition (and therefore low calling costs) which already benefit the UK consumer.

32. Additionally, in costing BT's services for price control and cost orientation assessments, Ofcom has allowed for the recovery of fixed and common costs, which contrasts sharply with Ofcom's proposals under pure LRIC for the mobile sector. Ofcom is obliged to take account of the desire to regulate in a manner which is technologically neutral. Its proposal to move to pure LRIC in respect of mobile voice call termination is entirely contrary to achieving that.

1.5 Concluding comments

33. In summary, Everything Everywhere believes that Ofcom's proposals fail to meet the requirement to fulfil the duties set out under the Communications Act and relevant EU Directives, that an adequate impact assessment has not been completed and that there are good reasons for Ofcom to depart from the EC Recommendation.

[12] Commission Recommendation of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC).
[13] MTR consultation, April 2010, paragraph 7.99.
[14] MTR consultation, April 2010, paragraph 1.10.1

2 KEY FEATURES OF THE MARKET

- Ofcom has ignored key features of the market, particularly that:
  - UK's mobile industry has a level of profitability that is unsustainably low;
  - growth in data services remains dependent on current pricing
  - Ofcom's regulation to date has failed to translate into benefits to callers to mobiles

34. In this Section, we set out key features of the market which have been given little weight by Ofcom even though they are critical to understanding the harm that would be caused by Ofcom's proposals.

35. The current UK mobile market is already delivering substantial consumer benefits and with the formation of Everything Everywhere, we anticipate that these benefits both will continue and increase. Consumer penetration is high, with the overwhelming majority of low income households being able to afford mobile services, as can be seen by Ofcom's own analysis[15]. The formation of Everything Everywhere will enable additional investments to take place in extending coverage and introducing new and better services. A wide range of tariff plans is available to consumers with almost two-thirds of UK consumers showing their preference for the current affordable PAYG tariffs which do not lock customers into any ongoing regular financial commitment. Competition is vigorous with four major network operators, a significant number of MVNOs, with more MVNOs expected to launch soon, and new entrants expected following the forthcoming spectrum auction.

36. Despite growth in data services, our customers continue to demand a reliable voice service. Voice continues to be the major source of revenue for UK mobile operators which is reflected in the substantial undertaking to refresh our 2G network.

37. The future sees increasing margin pressure for UK mobile operators significantly impacting our ability to compete with unregulated competitors and meet the requirement for further investment in new services, technologies and infrastructure. UK consumers will ultimately be harmed if the international

[15] Ofcom's "Mobile citizens, mobile consumers" (Figure 1) found that household penetration of mobiles at 93% now exceeds household penetration of fixed phones.

operator groups limit further investment in the UK and if increases in retail pricing limit the take-up of new services.

2.1 Low industry profitability

38. Realisation of the consumer benefits and the competition that characterises the sector is however taking place in the context of unsustainable low profitability. Table 1 shows that UK operators have been earning returns that do not even cover Ofcom's proposed cost of capital for the industry (let alone the higher level of WACC which is more appropriate). Despite the economic importance of the mobile industry, its return on capital employed remains much lower than many other major industries.[16]

Table 1 – UK mobile operators' returns (ROCE) are below the cost of capital

	2009	3 year average (2007-09)
T-Mobile UK	[✂]	[✂]
Orange UK	[✂]	[✂]
O2	[✂]	[✂]
Vodafone*	[✂]	[✂]
Industry average*	**3.37**	**5.23**
Ofcom's proposed WACC	**7.6**	**7.6**

[✂]

2.2 Risks to ongoing data services growth

39. Mobile data demand is growing strongly and consumers are being given access to a rapidly widening range of new services and applications. Ofcom has previously noted the significant consumer benefits offered by mobile broadband in bringing together "*the flexibility of the internet and ease and immediacy of mobility*".[17] However, Ofcom should be aware of two key qualifications to future growth in usage which put these benefits seriously at risk.

40. First, as explained in Annex E, [✂] Further, while LTE will bring additional capacity, current Government auction plans together with the unavoidable delays in consumer take-up of LTE devices will mean that capacity constraints will endure until [✂] Implementing LTE will only be possible if operators are allowed to earn returns that justify the required investments.

[16] See Figure 37 of GSMA, European Mobile Industry Observatory, 2009.
[17] Ofcom, "Mobile citizens, mobile consumers", 28 August 2008, para. 1.7.

41. Second, significant increases in data prices (as would result from a substantial shift in cost recovery away from termination) would severely curtail current growth rates in data services. Market research for T-Mobile[18] shows that:

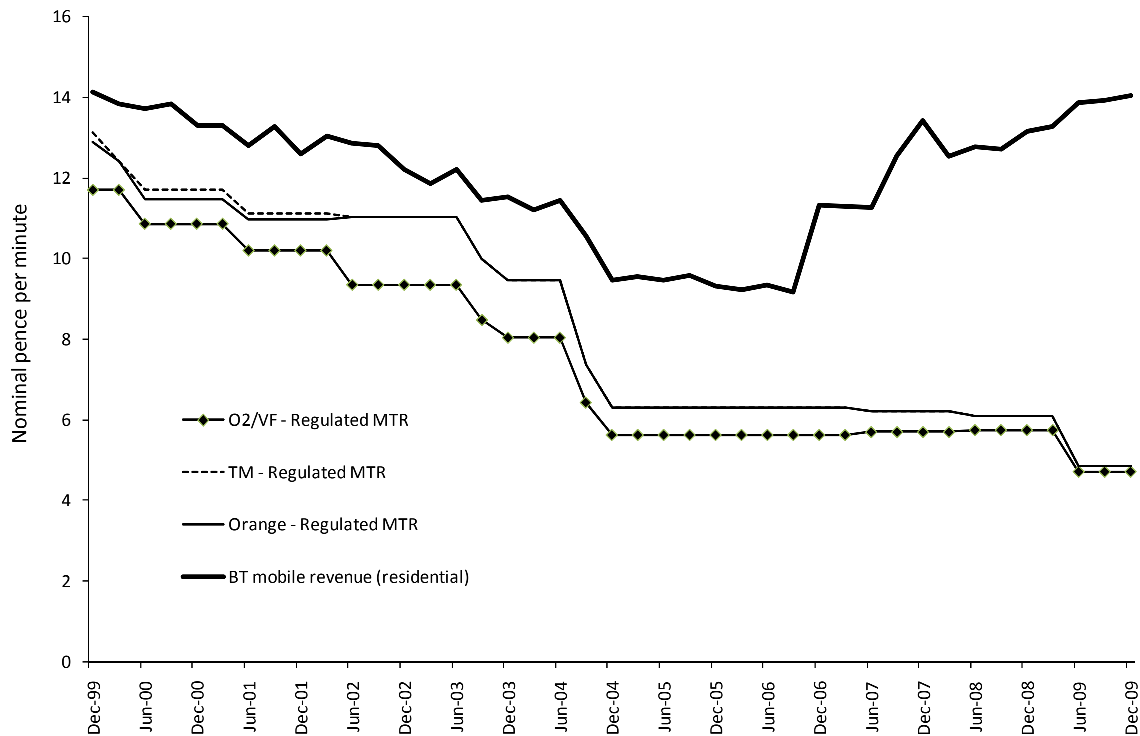
- 50% of PAYG customers would cease acquiring mobile data services altogether if prices increased by 25%; and
- 65% of post-paid customers would cease acquiring data services in response to a charge increase from £15 to £20 per month.

2.3 The failure of termination regulation to date

42. Over the last decade, Ofcom has imposed substantial cuts in mobile termination charges with the explicit aim of bringing cheaper calls to mobiles from landlines. However, despite continuing cuts in termination charges, BT's average revenue per minute on fixed-to-mobile calls has increased significantly since regulation of BT's retail prices and on the pass through of these cuts was removed from August 2006. In the period December 2006 to December 2009, mobile termination charges dropped by 16%, while Ofcom's own telecoms market data shows that BT's average residential revenue per minute rose by 24% and is now back to the levels of a decade ago (see Figure 1).

[18] Market research conducted by SKIM on behalf of T-Mobile, November 2009

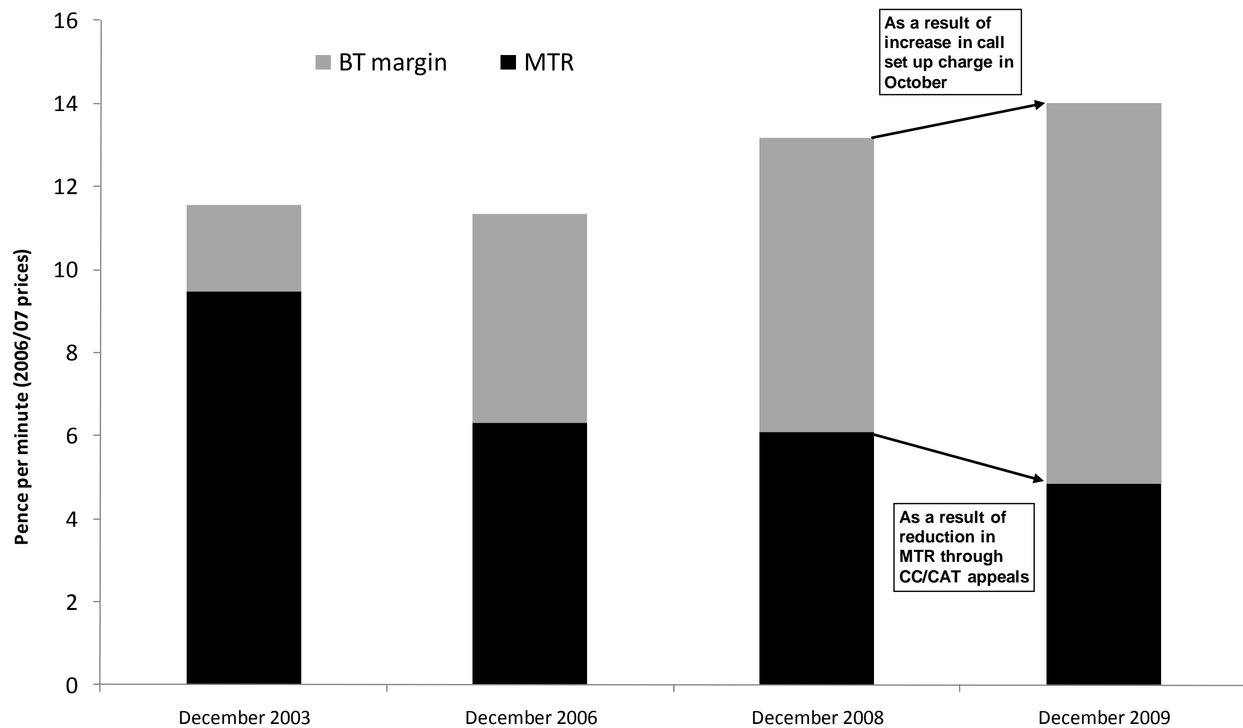
Figure 1 – Increasing fixed-to-mobile prices despite MTRs cuts[19]



43. As Figure 2 below shows more than half of the price of an average fixed-to-mobile call is now retained by BT, despite the cost of fixed technology and fixed origination being a fraction of the cost of mobile termination. This highly inefficient structure of prices has resulted, and been allowed to continue as a result of regulation of mobile termination charges without any consequential regulation of fixed-to-mobile prices.

[19] Calculated on the basis of Ofcom's telecoms market data and regulated termination rates.

Figure 2 - BT's growing retention on fixed-to-mobile calls[20]



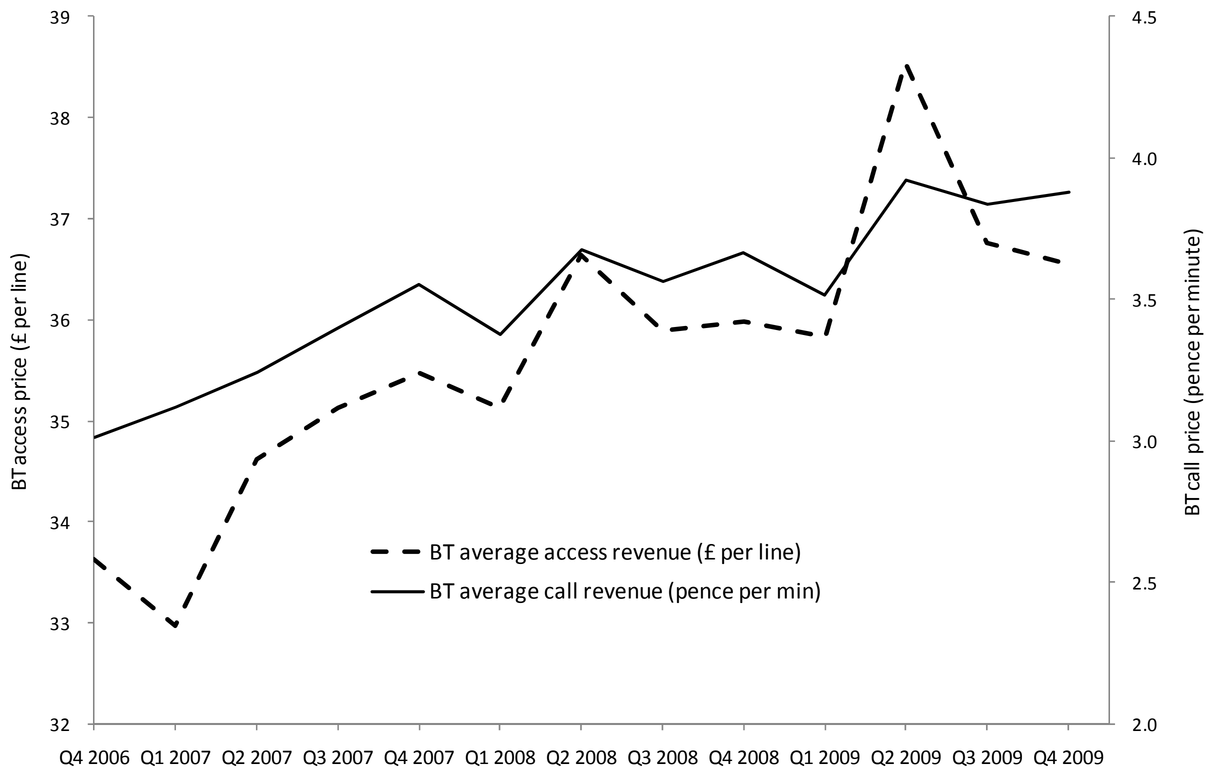
44. Ofcom has previously sought[21] to respond to the evidence on increasing fixed-to-mobile prices by arguing that even though fixed operators are not reducing fixed-to-mobile call prices, they could be reducing other fixed prices to the benefit of consumers. Given that termination regulation is primarily being put forward on the basis of achieving a more efficient structure of prices, it is absurd for Ofcom to suggest such regulation makes sense despite fixed-to-mobile call prices not falling. For instance, how is such regulation supposed to be remedying the harm identified by Ofcom[22] of under-consumption of fixed-to-mobile calls?

45. Moreover, Ofcom's response also falls on the evidence (again from Ofcom's own telecoms market data) which shows that as mobile termination charges have come down, general fixed prices (for both access and for calls) have been increasing. Figure 3 shows that in the period December 2006 to December 2009 (when mobile termination charges dropped by 16%), BT's average access revenue per line increased by 9% and BT's average call revenue per minute increased by 29%. A similar trend has occurred in the overall fixed operator market, where in the same period average access revenue per line increased by 8% and average call revenue per minute increased by 15%. This evidence shows why fixed operators have been so

[20] Calculated on the basis of Ofcom's telecoms market data and regulated termination rates.
[21] Ofcom, Mobile voice call termination, March 2007, para. A19.34.
[22] para. 5.31

vigorous in arguing for cuts in mobile termination. Sector analysts expect Ofcom's new proposals to further increase BT's profits. For example, Enders Analysis estimated that Ofcom's proposals would add an "*extra percentage point or two of growth on [BT's] divisional EBITDA over the four years*".[23]

Figure 3 – BT's increasing fixed access prices and call prices[24]



46. In summary, the mobile industry has been performing well for its consumers although there are significant risks to its ability to continue to do so: profitability is low; the data market is still in its infancy; and meeting growing demand will require substantial new investment. In contemplating a radical change in regulatory approach by moving to pure LRIC, Ofcom needs to carefully weigh up the costs and risks associated with such a change and make a realistic assessment of the expected benefits based on the clear evidence that gains from earlier cuts have been captured by fixed operators.

[23] Enders Analysis: BT 2009/10 Q4 results: strong cost control and better visibility, but a tough year ahead [2010-054]

[24] Calculated on the basis of Ofcom's telecoms market data and regulated termination rates.

3 OFCOM'S PROPOSALS WOULD REDUCE OVERALL CONSUMER WELFARE AND PARTICULARLY HARM LOW INCOME CONSUMERS

- Ofcom's proposals are based on assumptions about price rebalancing and the impact on consumers that are not supported by the evidence. In fact, pure LRIC will be likely to increase, not decrease, overall mobile call prices as well as other mobile retail prices.
- Ofcom's proposals will make mobile services less affordable and risk the loss of mobile access to a significant number of low income customers. Ofcom's proposals would also undermine the sustainability of current PAYG tariffs.
- As a consequence they would also substantially undermine the businesses of not only the established networks, but also of many MVNOs which typically have a significant focus on PAYG customers. Market exit by such MVNOs would be to the detriment of competition in the UK market.

47. In this Section, we assess the likely impact of Ofcom's proposals on consumers and MVNOs. We first assess the likely pricing response by operators before turning to consider the follow-on effects on consumers.

3.1 Pure LRIC will shift cost recovery to subscription AND call prices

48. Ofcom accepts that there will be a waterbed effect but assumes, without evidence, that the waterbed effect will only lead to higher subscription prices ("most likely from fixed charges"[25]) rather than higher outgoing call prices as well. This is unfounded as more than 60% of the UK market is on PAYG tariffs with no ongoing subscriber charges (see Table 2). This is direct evidence that: (a) consumers are high sensitive to fixed charges; and (b) Ofcom's assumption that only subscription prices will be affected overlooks the fact that only a minority of customers pay such charges.

49. As a consequence of this balance between PAYG/ PAYM, and the sensitivity of customers generally to fixed charges, Ofcom's proposals will force operators to focus price rebalancing from lower termination charges on outgoing calls prices. Even PAYM customers are highly reluctant to pay fixed charges with demand driving monthly recurring charges on tariffs to vary closely with the number of inclusive minutes within each bundle – as such, these tariffs are really pre-payment of bundled minutes which retain significant long-run marginal prices for calls.[26] As such, Ofcom's proposals should not be expected to reduce overall call prices. With marginal long term profitability in the UK market overall, call prices are likely to rise as operators suffer the loss

[25] Consultation Document, para. A12.48.

[26] In particular, if a PAYM customer wants to make significantly more calls, they will optimally end up paying more to acquire a larger bundle.

of contributions from fixed-to-mobile calls without any reduction in their marginal cost. Because of the waterbed effect, Ofcom cannot even be confident that off-net call prices will fall rather than rise.

Table 2 – Prepay percentage of UK customer base

	H3G	O2	Orange	T-Mobile	Vodafone	UK market
Share of customer base on prepay	32%	61%	59%	78%	59%	62%

Source: Merrill Lynch, European Wireless Matrix Q3 2009

50. The range of measures being considered by Everything Everywhere to mitigate against Ofcom's proposed changes includes:

- Charging for incoming calls (similar to the US model);
- Increasing call prices;
- higher upfront fees;
- introducing daily charges
- introducing expiry dates on PAYG voucher credit / reducing the time before vouchers expire; and
- a reduction, or elimination, of handset subsidies.

51. A combination of these measures is likely to be adopted in practice with the precise combination reflecting customer preferences and competitive interactions.

52. International empirical evidence also indicates that Ofcom's proposals are unlikely to lead to overall call prices falling. The CEG study for Ofcom[27] found that there is no robust statistical correlation between lower mobile termination rates and lower retail prices. Indeed, we note that the US and Canada with much lower termination charges have amongst the highest mobile prices in the OECD.[28] Prices for medium use baskets are over 230% higher in the US than in the UK and the OECD data shows that the usage charge component of these tariffs in the UK is lower than in Canada and not significantly greater than in the US. Even direct inspection of call prices does not suggest that prices are relatively cheap in North America. In particular, in North America,

[27] CEG, Wholesale termination regime, termination charge levels and mobile industry performance, 20 April 2009.
[28] OECD press release, 11 August 2009 (available at http://www.oecd.org/document/20/0,3343,en_2649_201185_43471316_1_1_1_1,00.html).

both the customer making the call and the customer receiving the call are charged for the call. On this basis, a call between two PAYG customers in North America will lead to total charges of around 28 pence per minute in the US and 44 pence per minute in Canada.[29] On the other hand, average UK PAYG call prices are around 22 pence per minute and prepay call prices can be as low as 8 ppm in Denmark despite termination charges being multiples higher than in North America.[30]

53. Once it is accepted that call prices will continue to contribute to the recovery of common costs, a key argument of Ofcom against LRIC+ falls away, i.e. the argument that LRIC+ "*has historically lead (sic) to wholesale termination and retail origination tariffs that do not reflect properly the underlying costs and its drivers*."[31] It is the existence of common costs that requires prices, for at least some services, to be above their incremental costs. Pure LRIC does not overcome this problem; rather it forces common costs to be recovered fully from subscription and outgoing services leading to large and highly inefficient differences between the prices of those services and their underlying incremental costs.

3.2 The evidence does not show that pure LRIC will lead to higher usage

54. Ofcom argues[32] that "*…if a switch to pure LRIC led to larger bundles that would mean that the marginal price of calls within the bundle will be zero. This is likely to significantly expand usage.*" However, this argument ignores that contract consumers have the ability to change the particular bundle of minutes they acquire and hence even for contract customers the marginal price of calls will not be zero over a timeframe relevant to the proposed charge control.

55. The introduction of charges for receiving calls in particular could significantly impact usage. The large number of PAYG customers in the UK have chosen PAYG precisely because it allows them to carefully manage their telecommunications expenditure. Charges for receiving calls would lead to these customers being reluctant to answer unexpected calls in the future - moreover market research[33] suggests that around a quarter of PAYG customers would stop using their PAYG phone if they were charged 3 pence per minute to receive calls.

[29] Based on prices for prepay plans offered by all the major operators in each country as reported on their websites (accessed on 24 May 2010) with the exception of T-Mobile USA which was excluded as its tariffs vary across a large range with the top-up amount; MTRs from Cullen International and Ofcom.. Currency conversions using Yahoo Currency converter.
[30] Same source as previous footnote.
[31] Consultation Document, para. A12.50.
[32] Consultation Document, para. A12.65
[33] Source: Market research commissioned by Orange and undertaken by GfK, June 2010

56. This is even more likely to be the case if there is a fall in charges to make calls which in turn would risk an increase in SPAM and nuisance calls as the originating party would no longer have to bear the full cost of the call they initiate.[34] Operators would also need to recover the cost from implementing new billing systems to enable charges to be imposed for receiving calls.

57. Ofcom also argues that countries with lower MTRs have higher usage. The CEG report for Ofcom found no statistically significant relationship between termination charges and usage and hence it cannot be concluded from a casual inspection of data that lower MTRs will lead to higher usage. Ofcom's analysis of the usage data in May 2009 is also likely to have significantly overstated usage in "B&K" markets because Ofcom assumes that only 20% of calls in such markets would be on-net (i.e. a smaller share than in many European countries) and, as such, double counted by Merrill Lynch because North American operators bill and record the minutes for both the customer making the call and the customer receiving the call. [✂]

58. While Ofcom has the evidence for all the UK operators, Ofcom appears to have ignored this evidence. Moreover, US mobile operators tend to offer unlimited on-net calling as part of many of their PAYM tariffs and hence the proportion of on-net calls in the US is likely to be significantly higher than the proportion in Europe. Ofcom is proposing a major change in regulatory approach on the basis of a highly unlikely interpretation of international data.

3.3 Pure LRIC will reduce subscriber numbers

59. The consultation document focuses on the ability of mobile operators to price discriminate on the retail side as if it were something new and something that represented an alternative framework to the principles of Ramsey pricing (or at least as suggesting that common costs can be recovered in subscriber prices without any harm to welfare). The fact that operators maintain a range of different mobile tariffs is not new and it should be noted that the bulk of UK consumers (and most likely the bulk of marginal customers) are on a handful of PAYG tariffs for which operators have very limited information or ability to price discriminate between customer types.

60. As mobile retail prices have come down across different tariffs, subscriber numbers have risen substantially. This indicates that the level of price discrimination that operators can achieve in relation to their retail prices nonetheless still means that changes in the overall level of retail prices do significantly impact subscriber numbers. [✂] Further, Ofcom itself notes[35] that

[34] The introduction of charges for receiving text messages in North America has led to consumer litigation (for instance, see http://www.mobileindustryreview.com/2008/05/us_operators_hit_with_sms_charges_suit.html).
[35] Consultation Document, para. 9.175

the results of the CEG study[36] for Ofcom suggest that a reduction of termination charges to pure LRIC levels will reduce mobile subscription numbers by around 3 per cent.

61. Ofcom seems to downplay the potential impact on mobile subscriber numbers by arguing[37] that lower termination charges will bring down mobile call prices and that this will support demand for subscription based tariffs. However, this is inconsistent with the fact unchallenged by Ofcom that (i) lowering termination charges will force up prices generally to mobile customers; and (ii) that the majority of customers prefer not to be tied to a committed payment (even with the introduction of much lower monthly tariffs through SIM only tariffs). As discussed earlier in this section, there is no reliable basis for expecting that mobile call prices will fall and hence no weight can be attached to the assumption that a changed structure of prices would moderate the loss in subscriptions.

62. We discuss the impact on subscriber numbers further in Section 3.5.

3.4 Ofcom has ignored the efficiency reasons for termination to contribute to common cost recovery

63. While Ofcom relies on the assumption that common costs can and will be recovered fully and 'costlessly' in subscription prices, Ofcom has ignored the following key reasons in favour of termination charges also contributing to the recovery of common costs.

64. First, as noted above, Oftel has previously acknowledged that the structure of demand for mobile services implies that termination should contribute a relatively large mark-up for common costs rather than no mark-up.[38] As the fundamental nature of mobile demand has not changed, we assume that Ofcom would still accept this point.

65. Second, as set out in Section 2, fixed operators have shown very limited, if any, pass-through of changes in termination rates into fixed-to-mobile prices. The smaller the degree of pass-through the greater should be the recovery of common costs in termination charges rather than other prices because with limited pass-through to retail prices there is less of an impact on demand from raising termination charges. Further, Ofcom has previously argued that limited pass-through in fixed-to-mobile call prices may not be a problem because fixed operators could have passed through savings from lower termination charges across a bundle of fixed services in a manner "*not inconsistent with efficient*

[36] Wholesale termination regime, wholesale termination charge levels and mobile industry performance
[37] Consultation Document, para. A12.55.
[38] Competition Commission's, Calls to mobile report, 2003, para. 8.54.

Ramsey pricing of fixed-line communications."[39] As the demand for termination is ultimately a derived demand from retail calls to mobiles, Ofcom's acknowledgement that cost recovery for calls to mobile can be carried out in a sophisticated manner sensitive to demand elasticities overturns Ofcom's perceived key benefit of pure LRIC. As such, it leaves all major efficiency arguments favouring LRIC+ over pure LRIC.

66. Third, we note that the existence of network externalities would suggest a higher mark-up is warranted on termination than suggested by a simple Ramsey pricing approach. The Competition Commission did conclude in its 2009 determination that the inclusion of a mark-up for network externalities is no longer appropriate. However, this conclusion was based on the market circumstances then prevailing. If Ofcom were to slash termination charges to a fraction of their current levels and thereby force mobile retail prices to rise sharply, then the case for a network externality mark-up should be re-assessed. Such a mark-up could be critical for the low income, marginal customers who may otherwise end up giving up their mobile phones as well as for the operators and MVNOs who disproportionately rely on those customers.

67. We also note and agree with the reasons Ofcom has stated as to why call externalities are not relevant to the pricing of termination. Market research undertaken for Orange in 2008 confirms that most calls for PAYG customers are made within a relatively small circle of [✂] Pure LRIC will harm vulnerable consumers

68. Consumers overall would be harmed if termination rates were set as low as pure LRIC, although there would be a disproportionally higher impact on prepay customers. Cutting mobile termination rates reduces the extent to which calling parties contribute to the cost of the mobile network and thereby increase the share of the cost to be recovered, if possible, from the mobile subscriber. Empirical evidence shows that 90 per cent or more of previous cuts in mobile termination charges across European markets were recovered in higher mobile retail prices.[40] This waterbed effect is fundamentally driven by the pricing constraints on operators – with lower termination revenues, operators cannot afford to retain the same, low, levels of mobile retail prices. Mobile customers who receive relatively large volumes of calls (and hence who generate significant termination revenues relative to outgoing call revenues) are likely to be made worse off as they would end up bearing sharply higher prices.

[39] Ofcom, Mobile voice termination statement, March 2007, A19.32. The ease with which Ofcom assumes that fixed operators can follow Ramsey pricing principles stands in sharp contrast with the Ofcom's continuing denial that Ramsey pricing principles could ever be relevant to mobile services (e.g. the Consultation Document, para. A12.46.

[40] CEP Discussion Paper No 827, October 2007, Testing the "Waterbed" Effect in Mobile Telephony, Christos Genakos and Dr Tommaso Valletti.

69. Ofcom's own survey found that 32% of customers receive significantly more calls than they make, implying that a large group of customers are likely to be made worse off as a result of reductions in mobile termination rates.[41] Among socio-economic groups D and E, the survey finds that an even higher percentage (37%) receives significantly more calls than they make. A redistribution that harms low income consumers should not be the objective of regulatory intervention and to risk the loss of access to telecommunications for a significant share of UK consumers is entirely inconsistent with Ofcom's statutory duties.

70. A related effect is in relation to the sustainability of prepay tariffs, i.e. the tariffs that more than 60% of customers in the UK have chosen to be on.[42] The popularity of prepay reflects the revealed consumer preference to avoid upfront charges in favour of the flexibility to vary payments by varying usage rather than being locked into contracts for large bundles and high fixed charges. This budgeting flexibility is particularly attractive to low income customers. Ofcom's data shows that while the majority of people with incomes over £30,000 are on contracts, the majority of people with incomes lower than £30,000 are on prepay tariffs.[43] Indeed, a significant proportion of low income customers are unable to demonstrate sufficient credit worthiness to access contract tariffs – these customers are particularly at risk from Ofcom's apparent view that all customers should switch to contract tariffs regardless of customers' own preferences.

71. Ofcom's assumption that consumer harm will be limited is based on the mistaken assumption that operators have the ability and incentive to recover lost termination revenues in such a way as to limit the impact on the most vulnerable and price sensitive customers. However, operators would not be in a financial position to support the substantial group of customers who would be made uneconomic to serve because of Ofcom's proposals.

72. Ofcom's proposals would impact disproportionately the PAYG segment because termination revenues are critical to the economics of providing services to PAYG customers. This segment has the highest number of low income citizens who make few outgoing calls. Amongst people with the lowest incomes (i.e. less than £11,500), 81% are reliant on prepay phones.[44] [✂]

73. [✂] The large impact of Ofcom's proposals would leave Everything Everywhere with no option but to recover the common costs of call termination from the retail market.

[41] Ofcom, Consultation on future regulation, 2009, Annex 10.2, p.2.
[42] Merrill Lynch, European Wireless Matrix Q3 2009
[43] Ofcom, The Consumer Experience, 2008, Figure 26
[44] Ofcom, The Consumer Experience, 2008, Figure 26.

74. [✂]Such a change would be expected to alter consumer behaviour with many calls being left unanswered or cut short. Further market research[45] suggests that around a quarter of PAYG consumers would stop using their PAYG phone altogether if they were charged 3 pence per minute to receive calls.

75. [✂] Market research[46] suggests that faced with an additional charge of 5 pence per minute for outbound calls 24% of PAYG consumers say they would stop using their PAYG phone.

76. Ofcom has suggested that their proposals could result in increased upfront charges. [✂] This represents a very substantial increase particularly as many new PAYG customers will have no upfront charge at present (eg those that acquire new SIMs to use in their existing phone). [✂] A significant proportion, [✂] of new PAYG connections are SIM only consumers.

77. Alternatively, revenues could be recovered by setting a daily charge for PAYG customers. Market research suggests that if a minimum daily charge of 15 pence per day was introduced for each day that consumers used their PAYG phone then nearly 30 percent of consumers would stop using their PAYG phone.[47]

78. While there is widespread take-up and high affordability of mobile services today, significant increases in upfront charges could readily affect overall telecommunications affordability for low income consumers. Mobile termination revenues help make mobile communications more accessible for low income consumers by enabling lower mobile retail prices. 28% of people on incomes up to £11.5k are mobile-only.[48] It is noteworthy that mobile penetration is substantially higher in the UK than in the US and Canada – countries which have much lower termination revenues.[49] If Ofcom's proposed regulation were to drive UK market outcomes towards those of Canada's, a sizeable proportion of the UK population would ultimately exit the market.

79. Ofcom emphasises greater retail flexibility as a purported benefit of the radical options proposed.[50] However, this is misleading as the impact of more severe termination regulation reduces the overall pricing flexibility available to operators. In particular, by forcing more costs to be recovered from mobile retail services, these options would reduce operators' flexibility over the level of retail prices. Particularly concerning is the potential risk to the sustainability of current prepay tariffs.

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[45] Source: Market research commissioned by Orange and undertaken by GfK, June 2010
[46] Source: Market research commissioned by Orange and undertaken by GfK, June 2010
[47] Source: Market research commissioned by Orange and undertaken by GfK, June 2010
[48] Ofcom, The Consumer Experience, 2009, Figure 14.
[49] Merrill Lynch, European Wireless Matrix Q3 2009 and Ofcom, The Consumer Experience, 2009, Figure 15.
[50] The Consultation Document, para. 2.36.

80. A Frontier Economics study estimated that a reduction in mobile termination rates to 2 euro cents would reduce consumer welfare in Western European countries by 11% (and potentially higher under other assumptions).[51] The result was based on elasticity estimates that indicated that the resulting waterbed effect would lead to a 9% fall in penetration. Other findings of the Frontier Economics study are also concerning:

- coverage is significantly lower in the US than in the EU;
- US consumers simply do not have available the same types of prepay tariffs that European consumers have chosen to adopt (instead US prepay tariffs can require significant minimum payments); and
- the number of medium and low usage subscribers in Europe who would be worse off in a US-style market is much higher than the number of European high usage subscribers who might benefit.

81. What is clear is that the effects of a move such as the one proposed by Ofcom in this consultation would have far reaching and difficult to predict effects on the mobile sector and on consumers. A significant regulatory shift of this nature can only be undertaken following a rigorous impact assessment and cost-benefit analysis, taking due account of the interests of consumers on low incomes.

82. Ofcom has suggested that a mandatory social tariff could be used to ensure mobile phones remain affordable. However, Ofcom has undertaken no analysis to demonstrate that imposing another layer of regulation to remedy the effects of Ofcom's MTR proposals would be more efficient than leaving termination rates closer to current levels so that the market can continue to deliver affordable tariffs. In fact, there are reasons to believe that the current market solution is more efficient and hence that such additional regulation would be unnecessary and contrary to the Government's, and Ofcom's, stated objective of removing unnecessary regulation. A subsidy scheme, similar to that currently offered by BT for fixed lines, to compensate such a large number of customers would be highly costly and a serious administrative burden. There would be no commercial reason for mobile operators to offer a specific low income tariff and such regulation would be unjustified given the lack of a universal service obligation on mobile operators (and no current regulatory failure). Any such new scheme would be addressing a problem caused by inappropriate regulation by Ofcom rather than remedying a deficiency in the market. It would also increase the regulatory burden, contrary to Ofcom's duties in this regard.

[51] Frontier Economics, Assessing the impact of lowering mobile termination rates, July 2008, p.4.

83. Moreover, to ensure that low income customers are not disadvantaged would also require the scheme to replicate the budgeting flexibility provided by current PAYG tariffs – a further administrative difficulty. There may also be significant additional knock-on effects resulting from many PAYG users giving up their phone which Ofcom has not considered. For example, it may be necessary as a result of these effects to make more payphones available across the UK, so as to provide the most disadvantaged consumers with some access to telephone services.

84. Ofcom does argue that fixed only customers will benefit from its proposals and that many of these customers are on low incomes. However, Ofcom has provided no evidence to show that

(i) fixed operators will pass through any of the reductions in termination charges (in fact, as discussed in Section 2, the evidence suggests the opposite, as fixed operators have failed to pass through previous MTR reductions); or

(ii) whether low income fixed-only customers can be expected to make any significant number of calls to mobiles (in this regard Ofcom's analysis of the distributional effects is incomplete and unreliable).

85. The available evidence indicates that severe cuts in termination charges (as would result from the adoption of the pure LRIC approach) would leave a substantial number of the UK population worse off, including a disproportionate number of low income customers. On the other hand, there is no reliable basis for expecting that sharp cuts in termination charges would raise overall consumer welfare.

4 OFCOM'S PROPOSALS WOULD HARM, RATHER THAN PROMOTE, INVESTMENT AND COMPETITION

- Ofcom's proposed pure LRIC approach is in conflict with established economic principles of efficient pricing and is inconsistent with the previous reasoned positions of Ofcom and the Competition Commission. No evidence has been offered to justify this sudden change in position.

- Ofcom says that the economic judgement on whether pure LRIC or LRIC+ is a better basis for the charge control "*is finely balanced*". It then states: "*in the absence of sufficient reasons to depart from the approach set out in the Recommendation, we think that it is appropriate to follow it*."[52]

- We disagree with both Ofcom's conclusion and its logic in choosing pure LRIC based on that conclusion. First, the economic judgement is not 'finely balanced' – a full economic assessment shows that LRIC+ is much more likely to support efficiency and overall consumer interests. Second, Ofcom's test for whether or not to adopt pure LRIC is flawed, in that it leads to a decision that does not take sufficient account of Ofcom's statutory duties and regulatory principles or established regulatory best practice.

- Ofcom's proposals constitute a serious risk to investment as Ofcom has substantially underestimated the appropriate level of MTRs under both LRIC+ and pure LRIC, particularly in relation to the cost of capital, allocation of costs between voice and data and the assumed traffic forecasts. Taking account of the key flaws in Ofcom's cost model, Everything Everywhere believes the appropriate mobile voice call termination rate should be based on LRIC+ and [✂]

- Ofcom's proposals would harm, rather than promote, competition particularly by distorting competition between fixed and mobile operators and by harming mobile competition including through undermining the MVNO sector.

- In the medium to long term this may result in a serious lessening of competition as operators can either no longer maintain investment in new products/services at the same level as before, or choose to exit the UK market.

86. In this Section, we set out our concerns in relation to the serious risks to investment and competition from Ofcom's proposals.

87. Ofcom is proposing the abandonment of the LRIC+ costing approach that has long been implemented by it, its predecessor Oftel and other expert industry regulators in favour of the narrow, pure LRIC approach put forward by the European Commission in its Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC). Rather than the gradual reductions in charges that have occurred to date, Ofcom's

[52] Consultation document, Para 7.110

proposals would lead to a sharp 80% reduction in termination charges from current rates over the next regulatory period which is contrary to all Ofcom's previous stated best practice to avoid regulatory shock for the industry and the consequent risk to future investment[53]. Such a change is achieved by preventing termination from making any contribution to the key costs of providing coverage (i.e. the costs required for callers to be able to reach mobile subscribers across the UK) and administrative costs (i.e. the management of the overall business including termination). While Ofcom may be tempted to ignore many of these arguments as re-iterations of previously stated objections, this would be to ignore: (i) the significance of the proposed change as compared to previous reductions; (ii) the significant level of additional investment needed in the short/medium term to provide new and continued services as current mobile networks reach saturation; and (iii) the necessary introduction of handset free and 24 month contracts since the last charge control.

4.1 Ofcom's LRIC model significantly understates efficient costs

88. The Consultation Document incorrectly states[54] that "*The key question is whether it is more efficient to recover common costs from a linear markup on MTRs or from retail services where MCPs have more pricing flexibility*." In fact, the key question is whether it is more efficient to recover common costs across the full range of services (including MTRs) or only from a subset of services (i.e. retail services). Economic theory on this point is unambiguous – it will always be better to recover common costs across as wide a range of services as possible unless demand for a particularly service is perfectly inelastic.[55] This result follows from the fact that the dead weight loss of pricing a service above its marginal cost rises exponentially with the level of the mark-up and hence applying even a small mark-up to an additional service will generally be less harmful to welfare than requiring even larger mark-ups on a subset of services. The efficient contribution to fixed and common costs should be determined, in accordance with Ramsey pricing, taking into account the relative demand elasticities of the different services sharing the common costs.

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[53] See e.g. Ofcom Mobile Call Termination Statement, paragraph 9.191: "In Ofcom's view, an immediate reduction to cost, while more effective in swiftly addressing competitive distortions, would not be in the longer term interests of consumers, as an immediate reduction in charges of up to 40% would present a risk to further investment in mobile services. An immediate percentage reduction of this size would go beyond regulatory precedents in mobile termination markets, where immediate reductions of no more than about 35% have been required, and even then, only under specific circumstances that do not apply here."

[54] Consultation document, para7.20

[55] In the latter case, this service should bear full cost recovery.

89. Both Ofcom and the Competition Commission (in the recent Determination[56]) have previously endorsed these principles of efficient pricing which find that termination charges should contribute to both the incremental cost of termination as well as making a contribution to fixed and common costs. As Ofcom noted in the last price review:

90. "in the presence of fixed and common costs of production, firms can break even only by setting prices that are higher than marginal costs. Ramsey prices are defined as those prices that maximise static efficiency under the constraint that firms recover all costs of production…it is efficient to have larger mark-ups on goods/services the consumption of which is less sensitive to price changes."[57]

91. While Ofcom accepted the economic reasoning as to why Ramsey pricing can support efficiency, Ofcom has previously chosen not to apply a Ramsey approach largely on the grounds that it is difficult to apply in practice.[58] Ofcom's LRIC+ methodology took account of efficient pricing principles and was put forward as striking "*a balance between relevant principles of efficient pricing and practicality*"[59] particularly given uncertainty over precise demand elasticities.

92. The Competition Commission endorsed Ofcom's approach finding that the fair charge for mobile termination should be "*based on the LRIC of call termination (including fixed and common network costs) and a mark-up for relevant non-network costs.*"[60] These principles were re-affirmed as recently as last year with the Competition Commission upholding Ofcom's approach to the allocation of the common costs of administration and noting:

> "*Ofcom considered these to be common costs between all of an MNO's activities, and as a result considered that it was appropriate for them to be recovered over all areas of an MNO's business that they help to support.*"[61]

93. The Competition Commission's determination last year also addressed the risk to investment from regulators acting opportunistically and inconsistently over time. The Competition Commission sought to reassure operators noting that *"Ofcom stressed that…it is in general very reluctant to depart from cost*

[56] Competition Commission, Mobile phone wholesale voice termination charges - Determination, 16 January 2009.
[57] Ofcom, Mobile voice termination statement, March 2007, paragraphs A17.8 and A17.12.
[58] For example, see Ofcom, Mobile voice termination statement, March 2007, para. A17.50.
[59] Oftel, Ramsey pricing and the incentives of mobile operators, 2002, para. 34.
[60] Competition Commission, Calls to mobile report, 2003, para. 1.6.
[61] Competition Commission, Mobile phones determination, 2009, para. 3.5.

recovery principles" and should Ofcom try to act inconsistently "*The MNOs are protected by the right of appeal to the Tribunal and the CC.*"[62]

94. Ofcom's new proposal to adopt pure LRIC would set termination charges at a level far removed from the efficient level required to maximise consumer welfare, in particular by increasing the mark up on retail services. Indeed, Oftel[63] has previously acknowledged that termination, rather than making no contribution, should make a more than proportionate contribution to common cost recovery:

95. Oftel said that the existence of the cross-price elasticity with respect to the price of calls from mobiles meant that the mark-up over cost in this price would be smaller than the mark-up on termination. Oftel said this was because increasing the price of calls from mobiles created a larger welfare loss than an increase in the price of fixed-to-mobile calls, since the former also resulted in a reduction in the number of subscribers (via the cross-price elasticity).[64]

96. It is one of Ofcom's guiding regulatory principles to:

    'strive to ensure its interventions will be evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome'.

97. The proposal to set the MCT charge control based on LRIC is clearly not consistent with previous decisions nor has new evidence been put forward to warrant Ofcom's departure from LRIC+. Indeed, Ofcom's new proposals conflict with precisely the approach Ofcom suggested to the European Commission in 2008. In particular, in a joint submission with the BERR, Ofcom argued[65] that :

    *'…the draft Recommendation proposes **a major departure** from established best practice without adequate justification for the departure. In particular, established best practice for cost-oriented termination charges based on long-run incremental costs includes a reasonable allowance for fixed and common costs'.*

98. The submission reiterated that:

    At the heart of our concerns is the lack of evidence-based justification for the approach taken to efficient cost recovery.

[62] Competition Commission, Mobile phones determination, 2009, para. 2.3.38.
[63] As Ofcom adopted charge controls in 2003 based on the earlier Oftel analysis (amended as necessary by the Competition Commission), we assume that statements by Oftel also represent the established view of Ofcom (at least until the latest proposals to depart radically from Oftel's/Ofcom's earlier approach).
[64] Competition Commission's Calls to mobile report, 2003, para. 8.54.
[65] http://ec.europa.eu/information_society/policy/ecomm/library/public_consult/termination_rates/index_en.htm

99. Ofcom was correct to describe the proposed change from LRIC+ to LRIC as a 'major' change. The regulated charge for termination would fall to a fraction of its established level if Ofcom were to implement a LRIC-based charge control. Therefore, Ofcom must pay close attention to its duties, and regulatory best practice generally, in making this decision.

100. Unfortunately, Ofcom has not made an economic case for change. Instead, it has chosen to highlight ambiguities, and to downplay the importance of established regulatory best practice. Ofcom's justification for a pure LRIC-based charge control amounts to acknowledging that there is no strong economic case for it, but that any associated problems don't really matter. This is not good enough for such a major departure from previous regulation.

101. Ofcom's proposal to adopt pure LRIC is fundamentally based on its assumptions that:

- Cutting termination charges will result in common costs being recovered fully from subscription prices rather than being spread across subscription and call prices;
- Mobile call prices will fall and this will increase usage.
- Higher subscription prices will reduce mobile subscriptions but not subscriber numbers materially.

102. As shown in Sections 3.1 to 3.3, these assumptions are in conflict with the evidence.

103. It is seriously concerning that Ofcom is proposing such a major change in regulation on the basis of assumptions that are so inconsistent with the evidence.

104. As well as the fundamental error of Ofcom's proposed pricing approach, Ofcom's cost model contains a number of key flaws which take the proposed charge control levels even further away from the level of efficient costs.

4.1.1 Ofcom's approach to the WACC and economic depreciation

105. Ofcom is proposing a new Weighted Average Cost of Capital (WACC) which is one third lower than the WACC used in the current charge controls. A major factor driving Ofcom's revised estimate are estimates of the beta for mobile operators measured during the period of the global financial crisis. In essence, mobile share prices fell less dramatically than the share prices for companies in the main sectors directly impacted by the crisis leading to low measured betas for the mobile operators. Ofcom has interpreted these low, measured average betas as if investors have permanently and dramatically altered their view of the risks of the sector. Other regulators however have taken the more

reasonable position of excluding data from the main period of the crisis to measure a less distorted longer run beta. We analyse these issues further in Annex B.

106. Ofcom's assumption that the cost of capital for the mobile sector has fallen sharply leads to an exaggerated and highly implausible view that the overall cost of termination has decreased suddenly from the estimated costs incorporated into the current controls. In particular, Ofcom's economic depreciation approach (which is intended to smooth costs over time) actually has the perverse result under Ofcom's new assumptions of exacerbating the effect of Ofcom's assumed reduction in the cost of capital. In Annex B, we also propose an alternative approach that would better meet the objectives of the cost model.

4.1.2 Allocation of costs between voice and data

107. Another key flaw in Ofcom's cost estimate is in relation to the proposed allocation of costs between voice and data services. Ofcom assumes that growth in demand for mobile data services will continue on the basis of established trends. However, Ofcom's cost model, on which it proposes to base the new regulation, actually implies an allocation of costs to data services which would force data prices to increase to multiples of their current levels. As explained further in Annex C, these two assumptions are wholly inconsistent – such price increases would severely curtail demand leading to much lower data traffic than the levels relied upon in the model. In Section 2, we have already noted consumers' very high sensitivity to data prices. This is the case even for post-paid customers with market research indicating that there would be a 95% reduction in demand for mobile data services if monthly charges for these services doubled.[66]

108. The allocation of costs between voice and data in Ofcom's cost model is completely inconsistent with the actual cost allocation decisions of operators in the competitive UK market. In particular, Ofcom has underestimated the relative contribution of voice services to incremental network costs, and has also (implicitly) allocated too great a share of common costs to data services. This error is clear from a comparison of retail prices for data in the UK, and the data unit costs that Ofcom's model produces. The modelled unit costs for data are an order of magnitude too high, which means that the modelled unit costs for voice services are too low.

4.1.3 Traffic forecasts

109. Ofcom has underestimated efficient costs by adopting voice and data traffic forecasts that are highly unlikely to be realised in practice. Ofcom's voice

[66] Market research conducted by SKIM on behalf of T-Mobile, November 2009

forecasts per subscriber are based on projecting forward an apparent growth rate from a few recent observations rather than taking a longer term average. Further, Ofcom's forecasts do not take into account the not insignificant risk that traditional voice traffic per subscriber may fall in future particularly with the growth in substitutes such as VoIP calls facilitated by rapid take-up of smart phones and improving VoIP applications for such phones.

110. We explain the problems with Ofcom's voice and data forecasts further in Annexes D and E.

4.1.4 Ofcom's implementation of pure LRIC

111. Ofcom proposes to adopt a pure LRIC approach in which termination charges would make no contribution to common costs particularly the cost of coverage and overheads. Ofcom proposes to implement an approach to pure LRIC which estimates a cost level one third (Ofcom's calculation) of that of Ofcom's LRIC+ approach. In doing so, Ofcom's approach assumes that the cost of providing coverage accounts for the majority of network costs. Ofcom's new unsupported assumption is wholly inconsistent with the detailed analysis of the nature of coverage costs provided previously by Oftel. In particular, in arguing against the significance of Ramsey pricing, Oftel provided a number of papers to the Competition Commission setting out why network common costs are "*relatively small common costs, comprising only about 3-5% of total network costs*".[67] In essence, Oftel argued that while operators incur significant costs (of around 20% of total network costs) to build a 'coverage network' enabling calls to be made and received across the network's coverage area, most of these costs should be correctly treated as part of the incremental costs of the services so as to promote overall efficiency. Oftel argued that "*There is an opportunity cost of capacity, ie when the initial capacity deployment is used for origination, the use of that amount of the capacity is denied to termination (and vice versa).*"[68] Ofcom has provided no explanation for now adopting the diametrically opposite view that network common costs account for the majority of network costs.

112. Ofcom has also modelled pure LRIC in a highly simplified way that fails to consider all the parameters that would change if operators were not to supply termination services. For example, sites in rural and remote areas are heavily reliant on voice revenues and if operators were no longer to receive revenues from terminating calls, a significant number of 2G and 3G sites would cease to be profitable. This is a serious issue that requires extensive, detailed modelling. The implication is that Ofcom's proposals would result in reductions

[67] See Oftel, Network Common Costs, 19 February 2002 and Oftel , Different Views of Oftel and MNOs on Network Common Costs, 27 May 2002.
[68] Oftel , Different Views of Oftel and MNOs on Network Common Costs, 27 May 2002, para.28.

of coverage, which is contrary to other work Ofcom is currently undertaking to encourage greater mobile coverage. However, Ofcom has simply assumed that coverage would remain unaffected by whether or not an operator supplies termination. As such, Ofcom has significantly underestimated the pure LRIC cost of termination.

113. Ofcom's pure LRIC also excludes a contribution to administration costs despite the efficiency of such a contribution and the Competition Commission determining in its resolution of the appeals against the current mobile call termination Statement that such a contribution is reasonable. Ofcom has presented no new evidence to justify the rejection of the Competition Commission's finding.

114. Ofcom also excludes termination contributing to HLR costs despite these costs mainly being incurred to support the supply of termination. As the Competition Commission found in 2003:

> "*the purpose of HLR updates is to enable an incoming call to reach the intended mobile handset more economically than if the whole network had to be paged each time a call arrived. Therefore incoming calls are also a cost driver. On balance, we concluded that the DGT's case for excluding the cost from terminating calls was not wholly persuasive: in the absence of call termination there would be no need for location updates. Hence, the fairer approach would be to allocate the cost across terminating calls including on-net calls.*"[69]

4.1.5 Treatment of spectrum costs

115. In principle, Orange has no objection to Ofcom's approach to spectrum costs in its consultation.

116. One caveat on this position is that Ofcom should manage change carefully. All five mobile operators paid large sums of money for 3G licences, and planned to recoup these investments over (at least) 20 years. The regulatory treatment of 2.1GHz spectrum costs, and the consequent impact on MTRs, has already changed considerably since the conclusion of Ofcom's last review of mobile call termination in 2007. Ofcom proposes further major change for the next charge control. The magnitude of these changes is such that they represent a significant operational disruption for mobile operators.

117. We also agree with Ofcom's view that an economic value approach, based on 'forward-looking opportunity cost', should apply to 1800 MHz spectrum as well as the 2.1GHz band. However, this issue is not entirely straightforward, because 1800 MHz spectrum is not yet liberalised, although it probably will be prior to 2014/15. We note that the implementation of this new approach to

[69] Competition Commission, Calls to mobile report, 2003, para. 2.271.

1800 MHz spectrum costs in Ofcom's current cost model might produce results that need to be interpreted carefully.

118. Our detailed concerns are set out in Annex F.

4.2 The appropriate level of charge control

119. These considerations show that Ofcom has substantially underestimated the efficient and fair LRIC+ and pure LRIC costs of termination. Equally concerning is Ofcom's willingness to adopt with little (if any) supporting reasoning or evidence positions that fundamentally differ (indeed are often diametrically opposed) to the previous positions of Ofcom and the Competition Commission. Where Ofcom is departing from established regulatory best practice, it must give its reasons for doing so, and must demonstrate that these provide an adequate basis for departing from the prevailing and previously adopted approach: Ofcom's willingness to abandon efficient pricing principles, consistency and evidence-based regulation will not only harm consumers in the short-term but by significantly raising the regulatory risk of investing in the sector will also cause significant longer lasting harm.

120. On the basis of the analysis in this section and the related Annexes, we believe that the appropriate mobile voice call termination should be based on LRIC+ and [✂] The following table summarises the adjustments that Ofcom should make to its cost model, and their impacts on the unit costs of termination. The impacts have been estimated cumulatively such that the changes in later rows of the table assume that the changes in the higher rows have been accepted.

Table 3 – Required corrections of Ofcom model

Scenario	Impact (ppm)	LRIC+ Level for MTR (ppm)
[✂]		[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]

4.3 Pure LRIC will harm, rather than promote competition

121. Ofcom's analysis of the likely competitive impact of a shift to pure LRIC considers only potential benefits and fails to take into account the serious risks to competition that would arise from such a change.

122. First, Ofcom assesses H3G's argument that termination charges lead to on-net/off-net price differentials that may harm competition.[70] We agree with Ofcom's conclusions that there is no evidence that any remaining differentials in pricing of on-net and off-net calls are adversely impacting (or ever did adversely impact) competition or consumer welfare. Smaller operators were the first to introduce discounted on-net calling and such pricing was a feature of European mobile markets throughout the period when these markets were becoming more competitive.[71] As Ofcom notes, discounted on-net pricing has become less common more recently with a degree of consumer preference for flatter tariff structures.[72]

123. Second, we believe that Ofcom's argument[73] that LRIC+ distorts competition between fixed and mobile operators is unsustainable; in fact the opposite is true. Mobile technology is inherently more costly than fixed technology with a key factor being the benefit of mobile coverage in enabling a mobile customer to be contacted anywhere in the coverage area. Fixed customers only contribute to the cost of a mobile network to the extent that they call mobile customers and hence use the mobile network. Under pure LRIC, fixed callers to mobiles would effectively be given the benefit of mobile coverage without making any contribution to its cost. As such, a shift to pure LRIC would be likely to introduce a distortion in favour of fixed operators where none exists

[70] Consultation document, para. A12.88ff.
[71] Sandbach, J., "Theory and practice of on-net pricing", April 2008.
[72] Consultation document, para. A12.90.
[73] The Consultation document, para. A12.92ff.

under LRIC+. Ofcom would be distorting demand in favour of fixed-to-mobile calls compared with mobile-to-fixed calls which would have to recover an even greater proportion of coverage costs. As fixed operators have been earning excessive (and increasing) margins on fixed-to-mobile calls, not only would this distortion directly harm consumers but it would also enable fixed operators to cross-subsidise other services for which they will increasing compete with mobile operators going forward. Furthermore, as set out in Section 5, Ofcom glaringly overlooks that mobile operators pay fixed termination rates that not only cover the common costs of the fixed network, but do so on a substantially more generous basis than that on which mobile termination rates are currently set.

124. Third, Ofcom has failed to take into account a likely significant competitive harm from the shift to pure LRIC. The UK currently has a very competitive service provider and MVNO market. In Q3 2009 nine MVNO were supplying 7.5 million consumers.[74] New MVNOs are being launched in the UK on an ongoing basis – [✂] Many MVNOs rely extensively on prepay customers. By undermining the economics of prepay tariffs, pure LRIC would also threaten the survival of these MVNOs and hence the additional competitive benefit they bring. Ofcom's proposals therefore carry a serious risk of greatly damaging the MVNO sector and therefore their contribution to competition in the UK mobile market.

125. Fourth, Ofcom has failed to recognise the risk created by mVOIP which may rapidly erode operators' voice revenue streams, substantially undermining the scope for the recovery of common costs to be achieved entirely from the retail side of the market as Ofcom's proposals assume. [✂] It cannot be appropriate for established operators to subsidise and support Ofcom's discrimination in favour of these new entrants. Instead, the termination charges of all operators should be regulated at the level of the efficient costs of their service provision. We expand on this further in Section 5.

[74] Source: Informa European MVNO subscriptions for Q3 2009 (issued Feb 2010), data relates to Asda, BT Mobile, Carphone Warehouse, Gamma Telecom, IDT Telecom, Lycamobile, Tesco Mobile and ToucanMobile

5 ASYMMETRY/SYMMETRY OF COSTING PRINCIPLES

- In costing BT's services for price control and cost orientation assessments, Ofcom has allowed for the recovery of fixed and common costs, which contrasts sharply with Ofcom's proposals under pure LRIC for the mobile sector.
- Ofcom is obliged to take account of the desire to regulate in a manner which is technologically neutral. Its proposal to move to pure LRIC in respect of mobile voice call termination is entirely contrary to achieving that.
- Ofcom recognises that significant cost differences between fixed and mobile technology should be reflected in different levels of charge controls. However, Ofcom unaccountably fails to accept that different charge controls should also apply between national mobile operators and niche players that do not provide a service of equivalent cost. Ofcom's proposal to regulate all players with a mobile number range at the same level results in unnecessarily high prices for consumers to call niche players and will distort competition in the overall market.

126. In this section, we discuss Ofcom's proposed approach to regulation as between fixed and mobile operators as well as between different mobile operators.

5.1 Discrimination in approaches to fixed and mobile regulation

127. This section of the response compares and analyses Ofcom's approaches to cost orientation and price control in different markets. It also assesses whether these divergent approaches, taken together, are consistent with the legal framework. It concludes that there are good reasons to doubt the legality of Ofcom's proposal to take a radically different approach to mobile networks when compared with fixed networks.

5.1.1 <u>Background – cost orientation</u>

128. The principles which Ofcom uses for cost orientation date back at least as far as the 1997 network charge controls for BT[75]. The charge control consultation document details the use of forward looking LRIC as the basis for charges, relying on the argument that such prices will help produce economically efficient decisions "*consistent with the workings of a contestable market*."[76]

129. This thinking continues to be reflected in the specific wording of "*basis of charges*" SMP requirements. The standard requirement for BT is that:

[75] http://www.ofcom.org.uk/static/archive/oftel/publications/1995_98/pricing/netcha97/contents.htm

[76] Oftel, Consultation on Network Charge Controls 1997, Para 3.3

> *"each and every charge offered, payable or proposed for Network Access covered by Condition ... is reasonably derived from the costs of provision based on a forward looking long-run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed."*[77]

130. In testing whether prices meet this requirement, Ofcom starts by considering distributed stand alone cost ("DSAC") and distributed long run incremental cost ("DLRIC") (which BT is obliged to publish). For example, in the recent draft determination on PPC charges[78] where Ofcom was investigating whether prices were too high, they state that:

> *"As a first order test, the maximum price that a firm can charge for a good or service in a contestable market (i.e. a market without entry barriers) is the stand alone cost ("SAC"). In the context of a multi-product firm such as BT, the setting of all prices at SAC would lead to over-recovery of common costs. Ofcom has therefore used the distributed stand alone cost ("DSAC") as the appropriate measure against which to assess whether BT's individual PPC charges were too high."*[79]

131. Ofcom goes on to say that this is consistent with the approach taken in the past, and reference Oftel guidelines[80] on the network charge control from 2001. It then goes on to describe that the most practical measures of incremental and stand-alone cost in these circumstances would be DLRIC and DSAC.

5.1.2 Cost ceilings and floors in the fixed market

132. The DLRIC of a service is the LRIC of the service plus a proportion of the costs that are common to the network increments which make up the service. This way, if all of the services which use that network increment are priced at DLRIC, the costs common to that increment will neither be over-recovered, nor under-recovered.

133. The amount of common cost which is included in the DLRIC relative to a fully allocated cost ("FAC") is determined by the definition and size of the increments. The larger the increment, the more common cost that will be included, and therefore the closer this gets to FAC.

134. Although DLRIC does include common cost, Ofcom and Oftel have stressed that this is merely used as a first order test, and that there may be reasons

[77] For example, see condition AA3.1 in the fixed narrowband wholesale services market review (i.e. fixed geographic call termination on the BT network).
[78] http://www.ofcom.org.uk/consult/condocs/draft_deter_ppc/main.pdf.
[79] Draft determination, para 1.17
[80] http://www.ofcom.org.uk/static/archive/oftel/publications/ind_guidelines/pcr1201.htm

why a price should fall outside of these boundaries. In fact, the Oftel Guidelines specifically noted that using this approach:

> *"it could be argued that floors set using this methodology are too high because they include a proportion of common costs and will therefore be higher than the incremental cost of a component (where the increment is defined as the component). Oftel would take account of this in investigating complaints about anti-competitive charging."*[81]

135. However, they do also note that the LRIC floor should be based on BT's incurred costs, and not those of an efficient operator, "*since this would provide a more appropriate guideline for anti-competitive low pricing that the incremental cost of an efficient operator.*"[82]

136. Hence, Ofcom has acknowledged that the price floor is intended to reflect realistic costs that might be incurred by a competitor. In this regard, the exclusion of all common costs would be perverse.

5.1.3 Ofcom's approach to BT's price controls

137. When setting price controls regulators have traditionally used a marked-up form of LRIC (e.g. LRIC plus Equi-proportionate Mark-up). More recently, however, Ofcom has used CCA FAC (or "current cost accounting fully allocated cost"). In relation to regulation of BT's wholesale call charges, Ofcom uses CCA FAC (or "current costs accounting fully allocated cost").

138. This is significant because under either LRIC+EPMU or CCA FAC, BT should recover an appropriate proportion of its fixed and common costs from the regulated charges[83]. This is quite different, of course, from pure LRIC.

139. In the latest network charge control, Ofcom chose to continue to apply a CCA FAC approach even though the end of the charge control period was after the date set by the Commission for transition to the approach set in the Recommendation.

5.1.4 The legal framework

140. It is apparent that Ofcom's proposals for MTRs are significantly out of line with the approach taken by Ofcom towards BT. There are two fundamental misalignments:

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81 Guidelines on the Operation of the Network Charge Controls from October 2001 - 7 December 2001, Para B17

82 Guidelines on the Operation of the Network Charge Controls from October 2001 - 7 December 2001 Para B7

83 Although BT's regulatory financial statements are audited, BT is primarily responsible for allocating common costs in a CCA FAC approach and this has led to a criticism that it allows BT to allocate common costs to regulated services (and away from competitive markets).

a) First, the costing methodology used for BT allows for the recovery of fixed and common costs. This is true both of the lesser "cost orientation" standard and also of the approach to price controls; and

b) Ofcom has shown itself willing to diverge from the EC Recommendation in respect of BT's charges.

141. In terms of the divergence from the EC Recommendations, as discussed above, we accept, and indeed advocate, that there are circumstances in which it is wholly appropriate for Ofcom *not* to slavishly follow EC recommendations.

142. Ofcom's dissimilar approach to price controls in the fixed and mobile markets is in *prima facie* contradiction of the legislative framework, which effectively requires that fixed and mobile networks are treated in a consistent manner:

a) The Communications Act provides that Ofcom must act in accordance with the requirement to "*take account of the desirability of Ofcom carrying out their functions in a manner which, so far as practicable, does not favour .... one form of electronic communications network... over another*."[84]

b) This rather reserved formulation is apparently Parliamentary Counsel's version of the various and much stronger provisions of the Framework Directive, including:

national regulatory authorities [shall] take the utmost account of the desirability of making regulations <u>*technologically neutral*</u> *[emphasis added]*

and:

ensuring that, in similar circumstances, there is no discrimination in the treatment of undertakings providing electronic communications networks and services.

143. The UK Statute must be interpreted in manner consistent with the Directive on basic <u>Factortame</u> principles.

144. This is basically the opposite of what Ofcom has done. Ofcom's approach effectively ensures the maximum possible disparity of treatment between mobile networks and the dominant fixed player.

145. In our view it is therefore in contravention of the statutory framework.

[84] Section 4(6) of the Act

5.2 Symmetrical rates for other SMP players

146. We welcome Ofcom's decision to regulate the termination rates of new entrants. Regardless of whether market definition is infrastructure or number range based, where an operator unilaterally fixes the cost at which it will sell termination services for the connection of calls to its customers that operator has SMP where, as in the case of the regulated MNOs, there is no alternative means of connection (i.e. they hold SMP for the same reason Everything Everywhere does).

147. While new entrants are necessarily less established than the currently regulated MNOs, actual and potential new entrants are typically robust in their negotiations and/or backed by established companies (e.g. Truphone/C&W). Most new entrants propose relatively high termination rates (whether absolutely, or in relation to the likely costs of providing termination). As these will typically be agreed as a matter of course by the relevant transit provider, new entrants effectively establish their rates via operators such as BT and C&W, which will not then subsequently negotiate these with originating CPs. Originating CPs are therefore in effect compelled to accept these rates, such that the cost of termination is effectively set unilaterally by the new entrant.

148. Exceptionally, some operators have sought to negotiate directly with new entrant operators on the level of the MTR they have agreed with a transit operator. In some cases this has subsequently resulted in a dispute. Nevertheless, as observed by Ofcom, the potential or actual referral of a dispute to Ofcom does not constitute countervailing buyer power, and it is of course possible to agree interim rates pending final resolution, enabling calls to be routed (such as those previously entered in to by T-Mobile with C&W). However, even where a new entrant does subsequently agree a lower rate this is not then reflected in the rate established via the transit operators and paid by other originating CPs. Accordingly, even where a new entrant's rates are successfully negotiated, this is of very limited impact since it will only take effect in that single bilateral relationship and will not impact on the MTR it achieves with other originating CPs.

149. Consequently, new entrants have succeeded in achieving termination rates equivalent to, or substantially higher than those charged by the regulated MNOs for the provision of termination on a national basis, regardless of their actual cost of termination. These rates are set independently of competitors, customers and consumers. Where a customer successfully agrees a lower rate this is itself exceptional, and occurs only in respect of that single bilateral relationship. It is therefore clear that new entrants are able to exercise dominance in the setting of their termination rates and may set these at an

excessive level. Regulating these rates is therefore clearly in the interests of consumers and the promotion of competition.

5.2.1 Benchmark rate not appropriate in all cases

150. It follows that we believe that a price control in respect of the MTRs of new entrants is necessary in order to ensure that these do not set MTRs at excessive levels. Nevertheless, we do not accept that the "benchmark" rate is appropriate in all circumstances. In the case of those new entrants operating full mobile services on a national basis, such as those which have agreed MVNO or national roaming contracts with the MNOs, it is accepted that they incur similar costs to the underlying network and that the efficient level of their MTR is the benchmark rate.

151. However, a large number of new entrants do not provide services which consumers would perceive as akin to the established mobile operators. This raises two issues.

152. First, it means that Ofcom's proposed regulation of termination rates by reference to number ranges is directly reliant on the number allocation process. We do not believe that the regulation of wholesale charges between operators should be set by reference to a prior administrative and procedural decision taken in isolation from considerations on the subject of efficient pricing. As Ofcom is well aware, we do not consider that Ofcom's current definition and/or interpretation of mobile services is appropriate, as it effectively determines that anything not directly plugged in to a wall is "mobile". While in a literal sense this is accurate, it does not reflect the real world reality that a customer provided with coverage only within 30m of their living room would not accept that to be a genuinely mobile service.

153. Second, regardless of the definition or characterisation generally of mobile services, the costs of providing termination to some new entrant services are substantially different to those of providing termination on a national basis. While Ofcom congratulates itself on finding a "technology neutral" solution to the regulation of voice call termination, it overlooks that the costs of providing termination – which is what it purports to regulate – are fundamentally linked to the costs of the technology employed to provide that service. Hence, where the costs of that technology, or the extent of the investment in it (e.g. whether service is provided on a local, regional, or national basis) are different, that is inherently related to the appropriate level of the regulated cost of purchasing termination.

154. This is significant because Ofcom concludes that charging the benchmark rate will in all circumstances be considered "*fair and reasonable*" ("F&R"). However, as noted by Ofcom in section 7 of the consultation, the basis of F&R pricing,

and its application, is akin to a requirement of cost-oriented pricing. However, where the national benchmark is set on the basis of the efficient cost of providing termination on a national basis through a particular mix of technologies, the provision of termination on a different basis using alternative technologies can de facto not be cost based, since the costs of providing such termination must be different. It follows that on its own definition of F&R pricing, the use of the benchmark cannot be fair and reasonable in the case of new entrant services using different technologies with different coverage – and therefore costs that are not in line with the level of the benchmark.

155. Consequently, we do not accept that a one-size fits all approach is appropriate. Even if it is accepted that two services are comparable at a basic level (i.e. they are both “mobile”), that common feature does not mean that there is not differentiation between them or that it is appropriate to disregard the extent of any such differentiation when determining an appropriate termination rate. Where there is a material level of difference in the likely level of costs that should be reflected in the accepted level of the regulated rate of termination. In these circumstances, it cannot be appropriate to use the benchmark on a universal basis since it will inevitably lead to the charging of excessive charges – contrary to Ofcom’s duties in the regulation of operators with SMP.

5.2.1.1 *Discrimination*

156. We believe that Ofcom’s approach of setting a single rate of MTR across all mobile number range holders (all of which it recognises as having SMP and therefore liable to set excessive prices unrelated to cost), regardless of real differences in the costs of established operators and some new entrant operators, is likely to be discriminatory.

157. First, the benchmark rate is set by reference to the costs of providing a call termination service (and the radio access layer) on a national basis. Even if it is accepted that new entrants provide a “mobile” service, many do not provide an equivalent service to that on which the benchmark is set. In such instances, Ofcom is treating dissimilar operators on a similar basis. Ensuring equal treatment is not a simple question of setting reciprocal rates, but ensuring that the basis on which those rates are arrived at itself avoids discrimination.

158. Second, Ofcom may wish to avoid the asymmetry in regulation but overlooks that reservations about asymmetric termination rates relate to the desire to avoid providing new entrants with an unfair advantage through imposing asymmetric regulation relative to other operators using the same network technology. Ofcom’s decision to cap the termination charges of fixed and mobile operators at different levels shows that Ofcom has elsewhere recognised the principle that cost differences arising from differences in

network technology should lead to different charge control levels. Furthermore, Ofcom has acknowledged in previous determinations that some mobile new entrants will likely over-recover using the benchmark and will therefore likely derive a benefit unavailable to other operators. Consequently, Ofcom's proposals will result in reciprocity but not the avoidance of asymmetry. We believe that this asymmetry of regulation is inappropriate and discriminatory.

5.2.1.2 *Competition*

159. Ofcom suggests that that setting a single universal rate for voice call termination will more effectively ensure competition. While we agree that new entrants should be regulated, competition is not served by allowing operators with SMP to set excessive charges unrelated to their costs. Where the costs of termination are not similar between all operators, the application of a single rate across all operators is inappropriate where real differences in costs exist, in particular where it avoids the requirement of cost-orientation that Ofcom should impose.

160. In practice, while setting a single rate may be appropriate among operators with similar networks, allocating this same rate to operators with very dissimilar costs may result in a very real distortion of competition. Ofcom suggests that the established operators could adopt the same technologies but fundamentally ignores that operators providing national coverage cannot in fact compete on the same basis as new entrants that cherry pick rollout or rely on a radio access layer provided and paid for separately.

161. First, although established MNOs and new entrants will, under Ofcom's proposed approach, recover the same termination rate for a call in a given location, Ofcom ignores that the costs of providing termination to an area with a high concentration of customers is significantly lower than the cost of providing the same service in areas of low customer density.

- Hence, Ofcom ignores that some new entrants will avoid the costs of providing high cost coverage that national MNOs cannot. While the established MNOs and new entrants may recover the same termination charge, and could potentially deploy the same infrastructure in a given area, national MNOs must also provide high cost termination outside that area.
- Even if it is assumed that a national MNO could retrench from the provision of uniform pricing across the country, either by (i) charging differential rates based on the cost of service, or (ii) supplying only high density areas in order to compete on a like for like basis, then Ofcom has manifestly failed to demonstrate that this would not have a negative impact on the consumer, or on competition generally.
- Hence, a national provider can never compete on an equal basis with an operator that can cherry pick.

162. Fundamentally, Ofcom's approach presupposes that it would be acceptable to discriminate between urban and rural customers, or that competition for rural customers is less important. Deciding to not serve higher cost rural customers is hardly a form of “innovation” or “technological efficiency” that Ofcom should be promoting.

163. Second, Ofcom broadly ignores the broader scope for a distortion of competition arising where call termination charges are not cost–oriented and operators derive significant margins between their actual termination costs and their wholesale charges. This is particularly acute in the case where new entrants do not incur, or otherwise recover, the costs of the air interface at the retail level, in which case any termination charge not solely based on core network costs is de facto excessive.

164. Hence, Ofcom is sanctioning and setting a precedent for excessive pricing by some new entrants. This cannot simply be ignored on the basis that it encourages new entry, particularly where it does not reflect any particular efficiency gain. The greater the margin between the actual costs of termination and the rates charged, the greater the scope for a distortion of competition. Ofcom's proposals suggest setting a policy that risks serious wider harm to competition.

165. For example, while we fully accept the likely growth of VoIP and commercial market developments, we do not accept that we should be required to pay above cost rates to new entrant VoIP operators to whom Ofcom allocated mobile numbers where the margin between their costs and charges is so significant as to enable them to cross-subsidise their retail offer. Ofcom's proposed actions may result in a significant distortion of competition and

undermine incentives for investment in network rollout (see further section [3] above).

5.2.1.3 *Consumer benefit*

166. Ofcom's proposed approach is predicated on the assumption that new entrants will pass through any margin over costs to consumers, that allowing it to recover such a margin rewards efficiency and encourages new entry, and that there will be no impact on competition (other than through the promotion of new entry, lower prices and innovation).

167. We believe that these underlying assumptions are flawed.

168. First, new entrants and their customers will in any event enjoy the benefit of their lower costs in the access and call origination markets. Accordingly, all of the positive factors that Ofcom cites above in favour of its determination will apply (to the extent that they apply) regardless of the position adopted in respect of wholesale charges for call termination. Ensuring that charges reflected costs would therefore continue to enable efficient entry. In fact, cost-based termination will increase the incentive for innovation and new, low-cost forms of entry because the new entrant will be forced to compete in the retail market on the basis of their actual costs rather than through cross-subsidies funded by discriminatorily lenient above cost termination rate regulation.

169. Second, other operators are customers of new entrant operators, and their customers (including those of other new entrants) are themselves consumers. The mobile market is highly competitive and, as such, a decision to allow new entrants to set significantly above-cost termination rates can be expected to harm consumers through inefficiently high wholesale prices.

170. Moreover, by effectively discriminating between mobile providers and allowing some operators to recover significantly in excess of their costs, Ofcom is in fact creating a distortion in the market. While supporting/funding new entry for low cost operators may be an appealing banner, the fact that this funding is provided by competitors (including other new entrants) will result in a distortion in competition through the transfer from efficient but cost regulated operators to non-cost regulated operators (i.e. new entrants with costs significantly different to those constituting the benchmark).

171. To dismiss this argument assumes that new entrants using alternative technology/models can only succeed in entering the market if they can benefit from a wholesale advantage over their competitors. Contrary to Ofcom's duties, this encourages inefficient investment in infrastructure. In effect, rewarding new entry through non-cost based discriminatory charging at

wholesale is mistaken, and overlooks that new efficient, low cost, innovative new entry is encouraged through cost-based termination regulation.

5.2.2 If using the same model behind the benchmark, then Ofcom must use relevant elements

172. If Ofcom accepts that all operators to whom it has allocated mobile numbers have SMP and must therefore be regulated in order to ensure cost-orientation of termination rates, then Ofcom must regulate those operators consistently.

173. Ofcom considers that this is achieved by an F&R obligation on new entrants, on the basis that the benchmarking them against the efficient costs of providing termination on a national basis sets a cost-orientation obligation. While that is the case for MVNOs and operators terminating a significant proportion of traffic via national roaming, that cannot be the case for operators not providing termination on a national basis/using different technology or business models. It follows that the LRIC based rate proposed as the benchmark cannot impose cost-oriented/F&R pricing if the operator to which it applies does not have similar underlying costs to those on which the benchmark is based.

174. The LRIC model estimates the average cost of supplying termination for a national operator. In doing so it ensures sufficient revenues for an operator that terminates a mix of traffic across both lower cost urban and suburban areas as well as higher cost rural and remote areas. Importantly, should the national operators experience growth in urban traffic relative to rural traffic then over time Ofcom's regulation adjusts so that the operators receive a lower averaged termination rate than otherwise. The model is also based on the costs of terminating this traffic over a certain type of infrastructure. It therefore reflects the costs of termination over 2G/3G mobile technology and thus sets a level that is not, for example, equivalent to the cost of termination over legacy fixed infrastructure.

175. This confirms that operators face different implicit long run prices for supplying urban and rural areas, using particular technologies, and it is these long run prices that are relevant for investment and network design decisions. Similarly, it confirms that Ofcom recognises that the cost of supplying termination services in areas where there is higher customer density is lower than elsewhere, and that it is appropriate to reflect this in the charges a network makes to third parties.

176. New entrant operators operating a national service using the investment made by an MNO in a national cellular network will incur substantially the same costs as those of the underlying network – and the appropriate charge for the

purchase of termination on this basis is therefore equivalent to that of the regulated MNOs.

177. However, many new entrant operators do not provide termination on this basis. Typically they either (i) provide localised coverage, providing termination services in urban areas where they target rollout to customers (ii) national coverage through termination using VoIP over the national 3G network of a third party (iii) nomadic coverage through termination using VoIP over third party fixed broadband Wi-Fi, or (iv) MVNOs or operators using national roaming.

178. Contained within the LRIC model is evidence to allow for the estimation of the cost of supplying termination in a more niche or localised way. This allows for the practical estimation of costs so that new entrants using different technologies or with different coverage can also have their charges set in line with efficient costs and thus avoid the distortion to competition from allowing them to set charges above costs. To allow new entrants falling in to (i) – (iii) above to receive the national average MTRs would allow them to earn revenues greater than efficient costs and effectively grant them a charge which is greater than the implicit long run charge faced by the national operators and new entrants failing in to (iv) above.

179. The LRIC model sets out efficient cost components as well as an efficient scale and mix of traffic reflective of an average operator. Although we have concerns with some parameter values used in the draft model, on the assumption that Ofcom chooses to rely on the model to regulate national operators then elements of the finalised model can be readily used to determine the efficient costs of niche operators. In its comments on the MCom decision, T-Mobile noted that the LRIC model could be used to calculate the efficient costs of a localised operator by calculating the efficient costs of supplying termination in each geo-type. Ofcom's MCom decision (para. A1.33) confirms that this approach is practical as Ofcom itself used its 2007 LRIC model to calculate the costs by geo-type in estimating the efficient costs of supplying termination in urban areas of 2.3 – 2.4 ppm (or 2.7ppm in 2006/07 prices once an efficient contribution to non-network costs is included). Similarly, the efficient costs of supplying call termination over a third party network (i.e. 3G or WiFI) using VoIP can be calculated using the core network costs set out in the model[85].

[85] VoIP operators do not incur any costs in providing call termination associated with the air interface, since the "last mile" connection is provided over a separately paid for interface (either the 3G network to which their customer also subscribes, or the fixed Wi-Fi broadband connection they have at home or have purchased connectivity to). Hence, allowing such operators to charge a benchmark rate derived from the costs of providing an air interface through a national cellar network is wholly inappropriate.

180. It follows that the LRIC model can also be used to help determine the efficient costs of new entrants, by identifying which elements the operator is using for termination and which are not already otherwise covered/ recovered. For the elements that remain to be recovered, Ofcom can estimate their costs in line with the LRIC model, such as in terms of Modern Equivalent Asset costs, asset lifetimes and the use of the best available forecasts. Where necessary, any basic key elements can be easily obtained from the operator (e.g. capital costs and the volume and mix of traffic).

181. Ofcom effectively dismisses such an approach on the basis of the supposed "difficulty in establishing the costs of rapidly evolving new entrant networks". However, this ignores (i) the fact that it has effectively modelled these costs already (as set out above) and can therefore rapidly establish the appropriate level of a LRIC based charge for a given type of operator; and (ii) that there is no basis on which to distinguish between operators such as Everything Everywhere and new entrants on the appropriateness of setting a 5 year charge control on us and not new entrants where we, like new entrants, are making substantial changes to our cost base and will do so throughout the next charge control period.

182. It follows that new entrants could, and should, be regulated based on the relevant components of the LRIC model for their scale and a mix of services, in line with their costs and their competitors. For example, VoIP operators should (only) be able to recover in termination charges a contribution to non-network costs that is consistent with the contribution in termination charges allowed to the national operators, while full MVNOs running a service based entirely on the underlying costs of their host network should recover the same termination charge as their host network.

183. Such an approach is consistent with promoting efficient competition as it would be the level of cost recovery that would result if a larger player also set up an alternative service of the same type as the new entrant's. We believe that few and relatively quick changes would enable Ofcom to make a robust and straightforward calculation of the likely efficient cost of a new entrant, whether individually, or by category. As in the case of the operators of national cellular networks, this can be done on a multiyear basis.

5.2.3 No regulation of retail rates

184. We note that Ofcom makes a number of remarks regarding the level of retail charges for calls to number ranges allocated to new entrants, making strong suggestions that reciprocity in termination rates should result in all ranges being placed within retail bundles. We consider that this mistaken for two reasons.

185. First, it suggests a degree of connection between these two markets that Ofcom has not established. While clearly wholesale and retail pricing are linked, operators are free to determine their retail prices independently and to set a variety of prices and packages for customers to choose from. Retail prices are determined by a wide set of factors, such as demand, competitor position, profitability, strategy, creating a portfolio of price points etc. It is not a simple question of a margin over the wholesale cost. Ofcom has not established that the link between wholesale and retail costs is so robust as to create a presumption that where wholesale costs are the same retail pricing should be also[86].

186. Second, Ofcom ignores its own acknowledgement that its power to dictate retail pricing is limited and is not linked to its regulation of wholesale rates. Ofcom has repeatedly found the retail mobile market to be competitive and it is therefore unclear on what legal basis Ofcom could make any intervention to set retail bundles. If the market is competitive then it will function in the interest of consumers and there will therefore be no reason, or basis, to intervene to govern what numbers are in bundle. In a competitive market consumer preferences will be met by operators such that if there is a competitive pressure to place all number ranges in bundle then this will be met. Indeed, some retail suppliers already place all new entrant ranges in bundle, while others do not. Consumers can therefore already choose between different types of inclusive bundles according to their own particular interest.

5.3 Use of the mobile number range as the basis for market definition

187. As noted above, Everything Everywhere believes that if SMP is found for the major mobile operators then the same logic implies that all providers offering termination to fixed or mobile number ranges should also be considered to have SMP.

188. We disagree with Ofcom however in believing that charges for termination to any mobile number range should be regulated at the same level. Recent years has shown that there are a number of fundamentally different types of entry into the mobile market and it makes no more sense to regulate these as if they had the same costs as it does to regulate fixed and mobile operators at the same level. Rather each type of operator should be regulated in line with its efficient costs. For example, an operator that only offered a niche service in relatively low cost urban areas should not be entitled to charges as if it were incurring the full costs of a national network. Similarly, a provider that is

[86] It should also be noted that Ofcom entirely overlooks the PAYG market (where consumers chose not to pay for a particular package of calls in allowance). The PAYG market represents the substantial bulk of all subscriber connections.

largely utilising VoIP technology should be regulated in line with its relatively low level of costs.

189. Regulating each type of operator in line with its efficient cost of provision achieves two major objectives:

- Callers to each operator do not pay unnecessarily high costs; and
- Competition is not distorted by some operators being allowed to earn excessive margins on termination which could be used to cross-subsidise inefficiently charged services and undercut competing providers.

190. We also note that Ofcom has raised a concern that where entrants have set excessive termination rates, calls to some of these entrants have been excluded from retail bundles (para 7.84). We agree with Ofcom that lower termination charges for entrants will help remove a barrier to their calls being included in bundles. Ultimately, however, in the competitive mobile market, it is for each operator to determine its own retail pricing arrangements. There is no basis for Ofcom to intervene to seek to modify retail tariffs so as to deliver more favourable treatment to some players.

191. Nevertheless, we do not believe that Ofcom has fully reflected the implications of adopting such an approach to market definitions in its model. The existing model assumes that on a long term basis an efficient operator will acquire a market share of 25%, based on there being 4 networks. However, once market definition moves away from control of the network, and to the allocation of mobile number ranges, with a consequent recognition that there are therefore a significantly larger number of competing operators with market shares (and aspirations to each increase their share), then Ofcom’s long term market share assumption must be altered. In particular, Ofcom cannot consistently argue that each of the major operator can achieve one quarter of the overall UK mobile traffic while at the same time regulating a growing number of new entrants. Ofcom needs to make a forecast for the reasonable share of the new entrants and adjust downwards the assumed traffic forecasts for the major operators in its cost model.

6 OFCOM'S PROPOSALS CONFLICT WITH OFCOM'S LEGAL REQUIREMENTS

- Setting an MTR based on pure LRIC is inconsistent with Ofcom's statutory duties under the Common European Regulatory Framework and the Communications Act.
- In order to comply with its statutory and legal duties, Ofcom should continue to set MTRs based on a LRIC plus approach.
- Ofcom must comply with its statutory duties even if this means departing from the EC Recommendation on termination rates (for which there is ample justification).
- Any material change to regulation legally requires a thorough impact assessment to be carried out.

192. In this Section, we set out our serious concerns as to why the approach Ofcom is proposing to adopt is in breach of its statutory legal duties.

193. The current LRIC+ methodology is the tried and tested best regulatory practice. As discussed in section 3, a move to pure LRIC methodology would have a detrimental effect on competition and investment incentives, would be contrary to the interests of consumers (especially those on low incomes) and would breach the principle of technological neutrality. A change to regulatory practice of this magnitude will legally require a thorough impact assessment including a robust cost-benefit analysis, which Ofcom has manifestly failed to undertake (such as in respect of the clear risk to PAYG customers).

194. Ofcom argues that: "in the absence of sufficient reasons to depart from the approach set out in the [EC's] Recommendation, we think that it is appropriate to follow it."[87]

195. However, this ignores:

- that Ofcom is not legally bound to follow the EC Recommendation.
- that Ofcom is legally obliged to comply with its statutory duties, even if that means departing from the EC Recommendation.
- Ofcom's own previously stated position on the consultation on the draft recommendation and the legal deficiencies of pure LRIC outlined in this Section
- Ofcom's own conclusion in this consultation that any decision to change approach is "finely balanced"

[87] Consultation document, Para 7.110

196. We conclude that, absent substantive evidence that (i) it is necessary to depart from the current approach; and (ii) that the new approach will not harm consumers but in fact provide significant overall benefits, the only option available to Ofcom which complies with its legal duties is to continue to apply the current LRIC+ cost model methodology.

6.1 Ofcom's legal duties

197. The EC Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC) (the "EC Recommendation") was issued by the European Commission under its powers in Article 19 of the Framework Directive (Directive 2002/21/EC). As Ofcom notes in the consultation document, national regulatory authorities are required to take the utmost account of such EC recommendations. However, recommendations are not legally binding and Ofcom is not obliged to follow the EC Recommendation blindly. Ofcom (i) can and should take a different approach where there are good reasons to do so and (ii) must demonstrate that where it does choose to adopt a different approach this will significantly improve the overall position and in so doing adequately justify the risk from a change to the established position.

198. In contrast to the non-binding nature of the EC Recommendation, Ofcom is legally bound by the EU Directives that make up the European Common Regulatory Framework and by the Communications Act 2003 (the "2003 Act"). The obligations and duties contained in the EU Directives and in UK legislation must take precedence over the EC Recommendation if there is any conflict between the two.

199. Ofcom's statutory legal duties and obligations include:

- promoting competition;
- promoting efficient investment and innovation;
- furthering the interests of citizens and consumers;
- having regard to the needs of those on low incomes;
- carrying out adequate impact assessments; and
- ensuring that measures taken are technologically neutral

200. The policy objectives and regulatory principles that all national regulatory authorities must apply under the Common European Regulatory Framework are contained in Article 8 of the Framework Directive, as amended recently by Directive 2009/140/EC. Prior to its amendment, that list included an obligation for national regulatory authorities to *"promote competition in the provision of*

electronic communications networks, electronic communications services and associated facilities and services by … encouraging efficient investment in infrastructure, and promoting innovation" (Article 8(2)(c) of the Framework Directive, unamended). In the re-cast Article 8 following amendment, this regulatory principle has been re-worded as a duty of "*promoting efficient investment and innovation in new and enhanced infrastructures*…" (Article 8(5)(d) Directive 2002/21/EC as amended by Directive 2009/140/EC). Although the wording in the Directive has changed, the duty to encourage and/or promote efficient investment remains. Any regulatory action taken or proposed to be taken by Ofcom must comply with this duty and must as a result allow for a reasonable return on the investments made by the operators concerned.

201. Article 13 of the Access Directive (Directive 2002/19/EC) applies where a price control condition is imposed. This provision provides that National Regulatory Authorities shall "*take into account the investment made by the operator and allow him a reasonable rate of return on adequate capital employed, taking into account* [the risks involved][88] [or] [any risks specific to a particular new investment network project[89]]" and "*National regulatory authorities shall ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition and maximise consumer benefits*."

202. These provisions are reflected in Ofcom's duties under sections 3 and 4 of the 2003 Act.[90] Ofcom's principal duties under section 3 of the 2003 Act are:

(a) to further the interests of citizens in relation to communications matters; and

(b) to further the interests of consumers in relevant markets, where appropriate by promoting competition.

203. Section 3(4)(d) of the 2003 Act requires Ofcom to have regard where appropriate to the desirability of encouraging investment and innovation in relevant markets. Ofcom also has a specific obligation in performing its duties to have regard where relevant to the needs of persons with disabilities, of the elderly and of those on low incomes (section 3(4)(i) of the 2003 Act). This reflects Articles 8(2)(a) and 8(4)(e) of the Framework Directive, as amended[91].

[88] Original wording of Article 13 of the Access Directive, prior to its amendment.
[89] Wording of Article 13 of the Access Directive, as amended.
[90] The 2003 Act reflects the 2002 directives, the amendments to the directives not having been implemented into UK law as yet.
[91] See also Recital 22 of Directive 2009/140/EC "In line with the objectives of the Charter of Fundamental Rights of the European Union and the United Nations Convention on the Rights of Persons with Disabilities, the regulatory framework should ensure that all users, including disabled end-users, the elderly, and users with special social needs, have easy access to affordable high quality services."

204. Section 4 of the 2003 Act incorporates Ofcom's duties for the purpose of fulfilling its Community obligations under, inter alia, Article 8 of the Framework Directive. These include the duty to promote competition (section 4(3)), the requirement to promote the interests of citizens of the European Union (section 4(5)) and the requirement to make regulations technologically neutral (section 4(6)).

205. Before imposing an SMP price control condition, Ofcom must also satisfy the legal tests in sections 87 and 88 of the 2003 Act. Ofcom cannot legally set an SMP price control condition unless a market analysis has identified that there is a relevant risk of adverse effects arising from price distortion and that the setting of the condition is appropriate for the purposes of promoting efficiency, promoting sustainable competition and conferring the greatest possible benefits on the end-users of public electronic communications services (section 88(1) of the 2003 Act). Section 88(2) provides that "*in setting an SMP condition falling within section 87(9)…*" (i.e. price control, cost orientation and cost recovery SMP conditions) "…*Ofcom must take account of the extent of the investment in the matters to which the condition relates of the person to whom it is to apply*".

206. As outlined in the preceding sections, the failure of Ofcom's proposals to allow for any recovery of fixed and common costs through the regulated call termination rate will result in under recovery on investments and will have a seriously detrimental impact on citizens and consumers. Operators will be forced to recover these costs elsewhere through other retail charges, which will impact on all consumers and especially those on low incomes.

6.2 Impact on efficient investment and competition

207. Our views on the impact that Ofcom's proposals will have on efficient investment and competition are set out above in section 4. Rather than promoting competition and investment, a move to pure LRIC as proposed by Ofcom would harm competition in and of itself and hinder investment (so further harming long term competition). Pure LRIC does not promote efficient investment as the return on capital employed is below the working average cost of capital and pure LRIC fails to take account of relevant investments. Pure LRIC creates a competitive distortion between fixed and mobile operators, is likely to cause significant competitive harm to MVNOs and fails to recognise or take account of the risk created by mVOIP. As a consequence, pure LRIC fails to comply with Ofcom's statutory legal duties to promote competition and efficient investment and innovation.

6.3 Impact on consumers

208. As noted above, Ofcom's principal duties under section 3 of the 2003 Act are to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition. In addition, Ofcom has specific obligations to have regard to the needs of persons with disabilities, the elderly and those on low incomes.

209. The pure LRIC methodology now being favoured by Ofcom assumes that fixed and common costs can be recovered from other retail charges such as monthly recurring charges. However, this ignores the fact that the majority of UK subscribers are PAYG customers (with no monthly charge). The introduction of pure LRIC-based MTRs will have a major impact on the UK mobile market resulting in significant distortions, especially as regards the attractiveness and viability of the PAYG market. This is significant in itself, but also because PAYG tariffs significantly over index among the elderly and those on low incomes.

210. Ofcom has assumed that lower MTRs will benefit all consumers or that the benefit for some outweighs the detriment for others. We have set out in section 3 above the reasons why a pure LRIC-based MTR would result in material harm for consumers on low incomes and will result in significant numbers of PAYG customers becoming uneconomic. In order to satisfy its legal obligations, Ofcom must have greater regard to the impact on all types of consumers, and especially those on low incomes, and weigh more carefully the potential benefits against the detriments.

211. We believe that failure to allow for the full recovery of costs will have a net detriment on consumers, not a benefit. Ofcom is under a statutory duty to act in the interests of consumers and should therefore favour the option that allows for full recovery without causing consumer detriment.

212. Ofcom's analysis also assumes that consumers of fixed communications services will benefit from lower MTRs. As explained in section 2 above, this assumption is erroneous. MTRs have fallen in recent years, whereas retail charges for calling mobiles from fixed lines have gone up (see figure 3 above).

213. We predict that the outcome of a move to pure LRIC-based MTRs would be that:

- PAYG and post pay mobile consumers will pay more to cover the common and fixed costs which can no longer be recovered through MTRs;
- consumers of fixed communications services will NOT benefit as fixed providers will retain the saving associated with the MTR reduction rather than pass it on to their consumers;
- with the ultimate outcome being an almost direct transfer from mobile consumers to the profits of fixed providers, and a significant reduction in the take up of mobile services, notably among those on low incomes.

214. That outcome is entirely inconsistent with Ofcom's duties.

6.4 Technological neutrality

215. Ofcom must ensure consistent regulatory practices and secure effective competition in the long term. Ofcom must also ensure that the regulation of electronic communications is technologically neutral (see Art. 8(1) Framework Directive and section 4(6) of the 2003 Act). See Section 5 above.

216. Ofcom has not followed or applied the methodology of the EC Recommendation in its recent review of the fixed communications market. The introduction of pure LRIC for mobile but not for fixed is not justified and favours one form of electronic communications network or service over another (i.e. fixed over mobile), contrary to the principle of technological neutrality enshrined section 4(6) of the 2003 Act and Article 8 of the Framework Directive).

217. Furthermore, among operators to whom Ofcom has allocated mobile numbers, Ofcom's approach is to only cost-orient the charges of operators that have deployed 2G and/or 3G networks, avoiding this requirement for new entrants by simply benchmarking them to the costs of 2G/3G operators regardless of the cost of their network investment.

6.5 Duty to carry out impact assessments

218. Under section 7 of the 2003 Act, Ofcom must carry out and publish an assessment of the likely impact of implementing any important proposals (or publish a statement setting out their reasons for thinking that it is unnecessary for them to carry out such an assessment).

219. Commenting on the need for impact assessments and cost-benefit analyses to be conducted, the Competition Appeal Tribunal has stated:

"It is the duty of a responsible regulator to ensure that the important decisions it takes, with potentially wide ranging impact on industry, should be sufficiently convincing to withstand industry, public and judicial scrutiny"

(*Vodafone & ors. v Ofcom* [2008] CAT 22 at paragraphs 46-47)

220. Ofcom is proposing a dramatic shift in the methodology it proposes to use. Not only does this amplify the need for evidence to demonstrate the necessity of this change, but it dictates that the assessment of the impact of that shift be robustly examined.

221. Given the dramatic shift that Ofcom is proposing to make in changing the cost model methodology from LRIC plus to pure LRIC, the material impact this will have on mobile operators and their incentives for efficient investment and the significant detriment to competition and consumers that will arise as a result, it is clear that Ofcom must undertake a full impact assessment including a complete cost/benefit analysis before completing this market review. A failure properly to conduct such an impact assessment would be a breach of Ofcom's legal obligations and would result in Ofcom's decision being subject to legal challenge.

222. It is telling that Ofcom made the same points in its comments on the draft Recommendation. Indeed, Ofcom's comments are of such relevance to the current proposals that it is worth reciting the relevant sections:

> *"We consider that [a move to pure LRIC] should include a more complete consideration of the impact, including the wider effect of the proposals on the retail prices faced by mobile and fixed subscribers. This is especially so, as there is the potential for adverse effects on some consumers, which might include those who are marginal or on low incomes, as well as beneficial effects of lower prices for calls between networks.*
>
> *We also believe that the draft Recommendation carries a risk of other unintended consequences[] Any major shift in the regulatory framework should be based on a comprehensive and robust analysis that takes full account of the implementation issues that could arise."*

223. We believe that Ofcom's proposals substantially adopt the position proposed in the draft Recommendation, and that this differs little from the final version that Ofcom cites. We consider that Ofcom's own concerns regarding the Commission's analysis apply to Ofcom's own, and that it remains deficient for all the reasons cited above.

6.6 The EC Recommendation

224. The LRIC+ option is the established regulatory best practice. It is the tried and tested methodology and complies with the legal duties in the Common Regulatory Framework and the 2003 Act. In contrast, the pure LRIC methodology preferred in the EC Recommendation does not.

225. It is notable that Ofcom was quite clearly opposed to the pure LRIC methodology when the European Commission consulted on its proposals in the draft Recommendation. The joint response of Ofcom and the Department for Business, Enterprise and Regulatory Reform ("BERR") stated that:

"While an examination of the extent to which reductions in termination rates can reduce the price of calls to consumers is clearly to be applauded, the conclusions must also consider any offsetting disadvantages that may arise. Shifting the burden of cost recovery away from callers towards call recipients is likely to feed through into changes in the level and structure of retail tariffs, which may benefit some consumers but has the potential to disadvantage others (such as lower-spending customers). These possible consumer disbenefits must be taken into account."

and

"Unfortunately, the current draft Recommendation is, in our view, not consistent with evidence-based regulatory best practice and should be adjusted before it is adopted. Principally, this is because:

(a) an assessment has not been made of the differential impact of the draft Recommendation on different classes of consumer, nor of the impact on the market players;

(b) the draft Recommendation proposes a major departure from established best practice without adequate justification for the departure. In particular, established best practice for cost-oriented termination charges based on long-run incremental costs includes a reasonable allowance for fixed and common costs. We do not think the draft Recommendation provides sufficient justification for changing to an approach where there would be no such allowance in regulated termination charges;

(c) in putting forward its methodology, the Commission has not, in our view, sufficiently identified why termination should be treated differently from other price-regulated services. We are concerned that there could be unanticipated adverse consequences if this methodology were to be applied more widely; and

(d) in a number of details, the draft seems, on the face of it, to be inconsistent with the 2005 Commission Recommendation on Accounting Separation and Cost Accounting Systems. Unless the Commission provides a clear reconciliation, the apparent inconsistencies will raise ambiguities about the ways in which these two Recommendations should be interpreted.

The fact that the Commission has recommended a particular approach does not of itself provide sufficient justification for adopting it, especially in the absence of adequate supporting analysis of rationale and impact. Unless these deficiencies are addressed, any account taken of the Recommendation could be vulnerable to legal challenge, not least because of the departures from previously established best practice. On the basis of the current draft Recommendation, we think that such a challenge would have a good chance of success in the absence of robust supporting arguments which have not yet been fully provided by the Commission.

At the heart of our concerns is the lack of evidence-based justification for the approach taken to efficient cost recovery. In the draft Recommendation there is little explanation for why the favoured approach is more efficient, either in theory or in practice. For such an important issue, with policy implications for many other regulated services and markets, we believe that further explanation should be provided to address these issues."

226. Nowhere in the current consultation document does Ofcom explain what has caused its change of opinion as regards the EC Recommendation. This is significant given that Ofcom itself acknowledges that a decision between the two is finely balanced. Where previously Ofcom, in a published consultation response, has described pure LRIC as a "major departure" from the established method "without adequate justification", it now seems happy to go along with it without any explanation as to the radical change in its stance on the matter, and the radical change that this will itself subsequently entail. It is submitted that, at the very least, Ofcom should explain why the views it appears to hold now are so different from those it held previously, and why these are adequate to justify a significant departure. As we noted at the beginning of this section, in the Consultation Document Ofcom states that "in the absence of sufficient reasons to depart from the approach set out in the [EC's] Recommendation, we think that it is appropriate to follow it." Ofcom's own previous objections to the European Commission's approach as set out in Ofcom's own September 2008 paper to the Commission were correct and contain sufficient reasons for departing from the EC Recommendation.

227. Furthermore, at paragraph 6.21 of the Ofcom's first consultation in this market review (June 2009), Ofcom commented:

"As highlighted in Section 2 above (see paragraphs 2.52 to 2.54), we are required both to consider and take "utmost account" of the EC's Recommendation. We see our approach in this consultation (that is, to consider a wide range of possibilities, that includes a close examination of the EC's recommended approach) as consistent with meeting those duties and obligations under UK and EU regulatory law."

228. It is of serious concern to us if Ofcom's view as expressed in that paragraph has changed such that it now feels that it has no choice but to move to pure LRIC. If it had been intended that compliance by EU member states with European Commission Recommendations was to be mandatory, words of greater strength than "utmost account" would have been utilised in describing the weight to be accorded to them or a form of instrument other than a Recommendation would have been used. Ofcom is wrong to assume that following the EC Recommendation should be the "default" position. Ofcom has legal duties to comply with, which mean that it must properly evaluate the available options. Having previously argued against a move to pure LRIC, Ofcom must if it wishes to change its publicly stated position clearly explain the logic and reasoning behind that change of view.

229. Ofcom also fails to account for the significant differences between the UK mobile market and the considerable majority of other EU mobile markets. The UK already has the lowest margins and return on investment of any EU market. For Ofcom to follow a recommendation which would properly apply to operators well able to cover their common costs elsewhere is to abjectly fail to take account of the specific circumstances of the UK, and the level of competition (and therefore low calling costs) which already benefit UK consumers.

230. Ofcom recently considered how to take the "utmost account" of an EC Recommendation[92] when considering leased line charge controls (Ofcom statement, 2 July 2009). That Recommendation has two distinct elements. First, it requires NRAs to ensure that the prices concerned "reflect only the costs of the underlying network elements and the services being requested including a reasonable rate of return". Secondly, it specifies caps for the prices for individual leased line services. It is clear from the Ofcom Statement that it considered it had complied with the first of those requirements. However, in respect of the second, despite the fact that the prices for some of the services concerned (in the UK) exceed the levels recommended by the Commission, it is not clear what, if any, account Ofcom took of the Recommendation (see for example paragraphs 4.178 and 4.179 of the

[92] European Commission Recommendation of 29 March 2005 on the provision of leased lines in the European Union Part 2 - Pricing aspects of wholesale leased line part circuits (2005/268/EC)

Recommendation). So the fact of deviation is clear; but the explanation behind it is not. Nevertheless, it is apparent that Ofcom believed it had significant latitude to divert from the Recommendation in this case.

231. We note that this decision is subject to appeal (CAT: 1112/3/3/09) and that the question of the account to be taken of the Recommendation forms part of this appeal. This may give clarity about the precise nature of the "utmost account" duty. Nevertheless, for the moment we consider Ofcom should apply the same liberal approach it took in the leased line decision to the current proceedings.

6.7 Conclusion on Ofcom's failure to comply with its legal duties

232. In the preceding sections of this submission we have shown how Ofcom's pure LRIC model will harm rather than promote efficient investment and competition and would reduce overall consumer welfare, harming low income consumers in particular.

233. Ofcom is not legally obliged to follow the EC Recommendation and, if it were to follow it, Ofcom would be in breach of its legal and statutory duties under EU and UK law. Ofcom is well aware of the flaws with the EC's approach, having previously stated that "*the Recommendation could be vulnerable to legal challenge, not least because of the departures from previously established best practice*".

234. Ofcom must ensure that any actions it takes do not favour one form of electronic communications network or service over another. If Ofcom were to apply the pure LRIC methodology to the mobile sector but not to the fixed sector, as would be the case should it make the proposed changes, it would be in breach of the EU and UK legal provisions on technological neutrality. We have identified in this response various modelling errors which must be corrected in Ofcom's final regulatory statement in this market review. Furthermore, any change to the regulation of the mobile sector of this magnitude would clearly require a full and detailed impact assessment and cost/benefit analysis to be carried out.

235. In order to comply with its statutory duties to promote competition, to encourage investment and innovation and to further the interests of citizens and consumers Ofcom should continue to apply the tried and tested LRIC plus cost model methodology in setting mobile termination rates.

7 OTHER CHARGE CONTROL DESIGN ISSUES

- We believe that Ofcom's other proposed regulatory obligations are generally reasonable although some modifications are necessary to make these proportionate.
- We believe that if Ofcom proceeds to implement its radical, pure LRIC approach a longer glide path is warranted to enable operators to develop new retail pricing models that take into account customer preferences and to enable Ofcom to monitor the effects of its proposal so that it can be modified if consumer and market detriment becomes apparent.

236. In this section, we discuss the additional charge control design issues as raised by Ofcom in its consultation document.

7.1 'Flip flopping' of time of day rates

237. To resolve the industry concerns that Ofcom states have arisen (although not conceding that this is the case), Everything Everywhere believes that the issue of "flip-flopping" can be resolved completely by the adoption by operators of a uniform rate for all times of day. For reasons of practicality, we would happy to adopt such a uniform rate. As discussed in Section 8, we believe that Capacity Based Charging warrants further consideration and could provide a superior way to better utilise capacity across times of day.

7.2 Comments on other proposed regulatory obligations (transparency, network access, undue discrimination, inclusion of particular calls)

238. In this sub-section, we comments on Ofcom's other proposed regulatory obligations.

7.2.1 <u>Need for transparency</u>

239. Everything Everywhere agrees that publication of rates is reasonable. However, we believe that a requirement for the publication of rates 28 days in advance is an unnecessary imposition on commercial processes and that the obligation should be limited to publishing current rates.

240. We also agree with Ofcom that price transparency alone would be inadequate to address Ofcom's concerns in regulating termination charges and smaller providers in particular show a clear tendency to set excessive rates prior to regulatory intervention.

241. We disagree with Ofcom's proposal for rates to be pre-notified to Ofcom. It is not a sensible use of Ofcom's resources to perform a check which can be adequately performed by all interconnect partners in confirming compliance with price controls.

7.2.2 Fair and Reasonable network access

242. Everything Everywhere believes that the fair and reasonable requirement would be insufficient for smaller MCPs. As discussed in Section 5 symmetrical rates do not take sufficient account of the efficient costs of the termination using across different operators. For example, allowing a niche MCP to earn rates based on the costs of a national operator will clearly be excessive when the MCP has only a cheap, limited network in low cost areas.

7.2.3 Undue discrimination

243. Everything Everywhere believes that whether particular conduct represents undue discrimination needs to be assessed within the specific context in which that conduct is taking place. Arising from this, undue discrimination can best be regulated through ex post competition law applicable to all players rather than attempting to do so through ex ante regulation on only some players that may unnecessarily restrict pro-competitive behaviour.

7.2.4 Inclusion of calls

244. Everything Everywhere agrees with Ofcom's proposals for which call types should be the subject of the regulation and Ofcom's general approach that all calls to mobile numbers controlled by an entity should be covered by the charge control. While we note that obligations should apply regardless of the technology used, the appropriate charge control level should be based on the efficient cost of the specific technology and level of coverage provided.

7.2.5 Right steps to monitor compliance

245. Everything Everywhere is concerned that Ofcom is presuming to step into the process in an invasive fashion, effectively providing a gate prior to notification of rates. We believe this is unnecessary, especially where compliance may become self evident. We are happy for Ofcom to have access to volume information for the purposes of monitoring but this should be done on a reactive basis such as in responding to a request or query.

7.2.6 Ability to provide information

246. Everything Everywhere can provide the necessary information. However, the timescales for providing the information are unreasonable. In particular, it would be excessive to effectively require 61 days notice for rate changes.

7.3 Glide path

247. Everything Everywhere is concerned that Ofcom is proposing that a severe reduction in termination charges be imposed to bring termination rates close to zero with a glide path of only four years.

248. Ofcom's proposal would imply a constant yearly percentage reduction in prices of 42.7%. However, Ofcom has previously acknowledged that a reduction of more than 35% in a single year could pose a risk to future investment.[93] We are particularly concerned that as termination charges are forced closer to zero, there is a greater risk of harmful, unanticipated effects. For example, Ofcom's proposals do not represent an incremental change on current arrangements but will require a fundamental review of operators' retail pricing models. Such changes can best be implemented from a consumer perspective by carefully testing consumer sensitivity to alternative options. However, this process both takes time to test and to review the alternatives. Cuts of 42.7% in a year will force operators to implement largely untested responses.

249. It is also the case that a more gradual glide path would allow Ofcom the opportunity to evaluate the effects of its proposals as rates come down over time. Should Ofcom find that its assumptions are not being borne out (such as call prices failing to fall and subscriber numbers starting to decrease) then Ofcom can modify its regulation before more severe harm is caused.

[93] See Mobile Call Termination Statement (2007) paragraph 9.191.

8 THE INTRODUCTION OF AN ALTERNATIVE CHARGING METHODOLOGY: CAPACITY BASED CHARGING (CBC)

- CBC offers the potential for significant efficiency gains without incurring the serious risks of Ofcom's proposed pure LRIC approach.
- Everything Everywhere believes Ofcom should now commence a joint Ofcom/industry working group to fully evaluate CBC and to investigate how to address the numerous implementation issues. On the basis of the findings of the working group and after a number of key uncertainties affecting the industry have been resolved, the desirability of switching to CBC should be re-assessed in 2 years.

250. In this section, we consider alternative cost methodologies to ensure consistency between fixed and mobile operators and to ensure that mobile operators are able to recover their efficiently incurred costs.

8.1 The benefits of CBC

251. In the Consultation Document, Ofcom acknowledges the efficiency benefits that CBC offers noting that it would better align wholesale pricing with the underlying structure of costs with costs being driven by demand for capacity. Ofcom also notes that CBC may be appropriate in the future but that there are a range of practical implementation issues that would need to be resolved.

252. T-Mobile and Orange have previously noted the potential for significant efficiency gains from CBC but that there significant implementation issues. For example, T-Mobile's response to Ofcom's 2009 consultation noted findings in the economics literature that:

253. As Kennet and Ralph have identified, CBC can lead to additional benefits over per minute charges in terms of:

- more efficiently aligning interconnection prices with costs;
- reducing the risk of inefficient facility-based entry;
- enabling additional mark-ups for overall cost recovery to be levied in a more efficient way than is possible with per minute charges only (the authors suggest an approach guided by Ramsey pricing principles);
- reducing the risk of distortions to wholesale competition (better aligning wholesale prices with costs can also reduce the risk of margin squeezes); and

- being better suited for Next Generation Networks providing new non-voice services as well as calls.[94]

254. Crucially, CBC could allow for the efficient recovery of fixed and common costs and avoid the serious risks associated with Ofcom's proposal to shift recovery of all of these costs on to only one side of the market.

255. In the context of a fundamental review of the regulatory approach, Everything Everywhere is disappointed that Ofcom has not sought to progress consideration of this option.

256. Ofcom is proposing a glidepath of rates to 2014/15. Within this timeframe a number of key uncertainties are likely to be resolved. In particular, over the next couple of years it is expected that:

- Ofcom will decide its approach to the future regulation of fixed termination charges;
- Greater certainty will be achieved in relation to the assignment of key mobile spectrum bands;
- Demand for data services will be more mature enabling better forecasts of its longer term evolution; and
- IP interconnection will be more established which would provide better guidance over the optimal interconnection charging arrangements in the longer term.

257. Everything Everywhere believes that Ofcom should use the next two years to coordinate a mobile and fixed industry working group to investigate the likely gains that could be achieved by CBC in practice and a plan to address the implementation issues. We would be happy to commit our resources to such a working group. While Ofcom proposed that it would not further explore CBC on the basis of "*little appetite apparent amongst industry players*",[95] we hope that Ofcom now agrees that this concern is not valid and commences the joint Ofcom/industry consideration of this important option.

258. In conclusion, we believe that Ofcom has prematurely dismissed consideration of CBC as part of the resolution of the current inquiry. Ofcom can instead better ensure that interconnection arrangements remain appropriate for the market circumstances by now commencing joint Ofcom/industry consideration of CBC.

[94] See Kennet, D.M. and Ralph, E., (2007), "Efficient Interconnection Charges and Capacity-Based Pricing", *International Economics and Economic Policy*, 4(2), pages 146,147 and 153.
[95] Consultation Document, para. 12.27.

ANNEX H – RESPONSES TO SPECIFIC QUESTIONS

Section 3: Market definition

Q 3.1: Do you agree with our views on whether and when new MCPs should form separate markets? Are there any factors we have not considered which should inform this view?

See Section 5.6 and Annex A.

Q 3.2: Are there any other types of providers we should also consider?

See Section 5.6 and Annex A.

Q 3.3: Do you agree with our views on the specific call types that should be included in the market? Are there any factors we have not considered which should inform this view, resulting in call types other than those identified being either included or excluded from the market?

See Section 7.2.4 and Annex A.

Q 3.4: Do you agree with our view of that the geographic market for each of our proposed markets should be the area of the UK within which the MCP provides and can set a charge for mobile voice call termination services?

See Annex A.

Section 4: SMP Assessment

Question 4.1: Do you agree with our view? Or are there other developments, not considered elsewhere in this consultation document, for potentially removing the underlying causes of SMP?

See Annex A.

Question 4.2: Do stakeholders have any comments on the analysis set out in this section?

See Annex A.

Question 4.3: Are there any other providers with SMP that we have not identified?

See Annex A.

Question 4.4: Do stakeholders agree with our proposed SMP assessment for the period until 2014/15?

See Annex A.

Section 5: Issues arising from a finding of SMP

Question 5.1: Do stakeholders agree with the identified harm to consumers of excessive termination rates in the period 2011 to 2015?

See Annex A.

Question 5.2: Do stakeholders consider there to be any other forms of relevant consumer harm that we have not identified?

See Annex A.

Section 7: options for regulation – selecting a preferred remedy

Question 7.1 – do stakeholders agree with Ofcom's view regarding the need for transparency in MCT charges?

See Section 7.2.1.

Question 7.2 – Do stakeholders agree with our preliminary view on application of a condition requiring network access to be provided on F&R terms?

See Section 7.2.2.

Question 7.3 – what are your views on the need for an ex ante undue-discrimination condition for the period of the next review?

See Section 7.2.3.

Question 7.4 - Do stakeholders believe that there are any circumstances or situations where the UK differs from other EU markets to the extent that would support a departure from following the EC Recommendation?

See Section 6.6.

Question 7.5 – do you agree with Ofcom's proposals for its preferred set of remedies for the provision of MCT services?

See Sections 2 to 7.

Section 9: Assessing what is an appropriate charge control

Question 9.1 – Do you agree that a four-year period for the SMP remedies is appropriate?

See Section 7.3.

Question 9.2: Do you agree with our proposed modelling approach, as discussed in this section, the supporting annexes and the actual model? If not, please discuss the specific proposals you disagree with.

See Section 4.1 and Annexes B to F.

Question 9.3: What is your view of the harm caused by flip-flopping? Please provide evidence to support your response.

See Section 7.1.

Question 9.4: Do you agree with our preferred option for resolving the issue of flipflopping – i.e. charge changes restricted to the first day of each quarter and a 20% cap on individual time of day rate increases? If not, why not? Which is your preferred option and why?

See Section 7.1.

Question 9.5: Are there other, more proportionate solutions that we should consider?

See Section 8.

Question 9.6: Is it clear which types of calls are included in, and which types are excluded from, the new charge control and in turn the compliance calculation? If not, which call types do you want clarified?

See Section 7.2.4.

Question 9.7: Is Ofcom taking the right steps to monitor compliance?

See Section 7.2.5.

Question 9.8: Are MCPs able to provide the information required to demonstrate compliance and for Ofcom to monitor compliance?

See Section 7.2.6.

Question 9.9: Do you agree with the conclusions of our distributional impact assessment?

See Section 3.5.

Question 9.10: Do you agree with our EIA, that reducing MTRs will have no significant impact on any specific identifiable group? If you disagree with this statement we would welcome any evidence you hold showing why this statement might be incorrect.

See Section 3.5.