TalkTalk

<u>NON-CONFIDENTIAL VERSION</u>

Wholesale mobile voice call termination

Comments by TalkTalk Group

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Introduction

Ofcom is proposing a radical reduction in mobile voice call termination rates which would fall to 0.5ppm for all mobile networks by 2014/15. The main reason for this reduction is that Ofcom would set the charge control on a “pure LRIC” basis rather than, as now, LRIC+ basis (although on a LRIC+ basis the rates would still be reduced to 1.5ppm over the same period of time).

TalkTalk Group welcomes Ofcom’s proposal which we believe will have a transformational impact on the retail market for calls to mobile phones. We see a number of positive effects including:

- We expect competition to drive down fixed to mobile retail rates and ultimately lead to the inclusion of mobile calls in fixed bundles similar to how calls to fixed numbers (and 0845/0870 numbers) are currently available in competitively priced bundles. It is naturally difficult to predict at what point in time over the next charge control period that this development might take place. This is likely to depend on the commercial decisions of individual market players and the competitive constraints created by a “go first” decision of any of the large providers.
- The significant reduction in mobile termination rates will all but remove the ongoing transfer of wealth from fixed telephony customers to mobile customers. As recognised by Ofcom, a fixed customer currently pays considerably more to call a mobile customer than the other way around.
- It will make competition between fixed and mobile fairer. At the moment the effective price of mobile termination for mobile originated calls is less than fixed. The average mobile retail price per minute is less than 3ppm[1] for calls to mobiles whereas for fixed operators the average retail price is 5 to 10ppm for the same calls to mobiles. This inequity diminishes the effectiveness of competition.
- It will result in increased call volumes across mobile and fixed networks.

[1] For instance, a £15 SIM-only 12 month contract buys 600 minutes of calls (as well as unlimited texts) which equates to 2.5ppm.

Though there are clearly incrementally greater benefits from a MTR of 0.5ppm than 1.5ppm we believe that some of the benefits (such as inclusion in bundles) will require the price to be as low as 0.5ppm.

We note that in the case where termination rates as set as 'pure LRIC' then the common costs associated with call termination will need to be recovered from other services. We do not see this 'waterbed' effect as detrimental and agree with Ofcom that any excessive mobile retail prices are very likely to be competed away.

With regard to the proposed methodology of setting mobile call termination rates on a pure LRIC basis, we would note here that the same methodology would not necessarily and automatically be justified and correct in setting charge controls on fixed call termination rates. There is very likely to be a host of economic and competition factors that distinguish the markets for fixed and mobile call termination. We do not intend to go into any greater detail on this issue here but would note the following factors:

- The UK already has some of the lowest fixed call termination rates in the EU and are obviously considerably lower than mobile call termination rates (even after a pure LRIC approach would have been adopted to mobile rates). The additional consumer benefit (e.g. traffic stimulation, bundling, competitive neutrality) that could be achieved by applying pure LRIC to fixed call termination rates would therefore be very small;
- There is no significant transfer of resources from the mobile to the fixed sector because of current fixed call termination rates which causes a competitive issue in need of addressing;
- BT also has SMP in wholesale voice markets other than fixed call termination rates (call origination and transit) which means that common costs may have to be recovered in those markets to the detriment of competitors who have no option but to buy those services from BT; and
- LLU operators like TalkTalk Group have had to port the telephone numbers for virtually all its customers which means that BT levies an average porting conveyance charge (APCC) leading to an effective reduction in the call termination rate received by TalkTalk Group. If the pure LRIC approach is applied to call termination but not the APCC, LLU operators may de facto have to pay BT to terminate calls on their own network (because their termination rate is set with reference to BT's through the current reciprocity arrangements). One way of addressing this would be to (correctly) consider the APCC as an incremental cost of termination.

TalkTalk also welcomes Ofcom's proposal to put a stop to the harmful and unjustified practice of "flip-flopping". Over the past couple of years, this practice has spread to all the mobile operators and, despite our requests to some of them, they have failed to provide a single logical explanation as to why they do this.[2] It is therefore an entirely proportionate regulatory response by Ofcom to impose a specific remedy on the mobile operators to prevent this practice from causing further operator and, ultimately, consumer harm.

[2] In fact we welcome the explanation given by Ofcom in the consultation document.

In the following section, we respond to each of Ofcom's consultation questions in turn.

<u>Responses to Ofcom's questions</u>

Question 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?

We agree with Ofcom's views.

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

We are not aware of any other types of providers.

Question 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?

We agree with Ofcom's view. It is appropriate to include all possible types of calls in the definition. The exclusion of ported-in calls is merely the necessary result of the mobile porting regime.

Question 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?

We agree with Ofcom's view.

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?**

We strongly agree with Ofcom's view that SMP exists in mobile call termination. There are very weak if any competitive constraints that would prevent mobile operators from exercising market power in this economic market.

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

We fully agree with Ofcom's analysis as summarised in section 4.90 of the consultation document.

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

We are not aware of any other providers.

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

Yes.

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

We agree with Ofcom's analysis of potential consumer harm that would follow in case mobile termination rates were not subject to effective SMP remedies.

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

No, we believe Ofcom has correctly and exhaustively identified all forms of relevant consumer harm.

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

Yes we believe transparency is incredibly important. We believe that mobile operators should also be specifically required to publish up-to-date termination rates in a clear and easy-to-find manner on their respective corporate websites. This information cannot be easily found at the moment (and in fact has never been so).

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?

Yes we agree with Ofcom's preliminary view.

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

We believe it is essential to impose an ex ante no-undue discrimination obligation on the five mobile operators to prevent any potential price and non-price discrimination from arising that would cause competitive distortion and consumer harm.

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?

We do not believe there are any such circumstances with regard to the market for mobile voice call termination for the reasons outlined in the consultation document. That said, we would emphasise that this conclusion should not be taken to mean that the same could be said for the market for fixed call termination in which the economic circumstances are likely to be very different.

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

Yes we agree with Ofcom's proposals.

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

Yes we agree a four-year period is appropriate. This period of time provides commercial certainty and is also consistent with previous charge control periods.

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.

Although we are not extremely familiar with all the details of the complex modelling approach, it does appear reasonable.

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

Flip-flopping is a practice that mobile operators have started to engage in only during the last 2-3 years. It certainly never used to be an issue for fixed originating operators like TalkTalk Group. However, the practice has now introduced a great deal of commercial uncertainty into our business whereby our commercial planning is compromised in an unfair and undue fashion.

[redacted]

TalkTalk strongly believes that this simple and easy-to-understand charging structure is attractive and beneficial to customers. This means that the cost of any rise or fall in mobile termination rates is borne by TalkTalk.

Flip-flopping cause concern since it makes our commercial planning less predictable with regard to one of the largest revenue drivers in our telephony business. The uncertainty caused by flip-flopping reduces and delays our ability to pass through any mobile termination reductions to our customers who will be disadvantaged as a result. Furthermore, it adds (unnecessary) cost since we effectively charge extra to cover the additional risk that we bear.

[redacted]

We are therefore of the view that flip-flopping is causing harm to purchasers of mobile call termination and, ultimately, to consumers (whether residential or business) who may not benefit from the gradual reduction in mobile termination as quickly as possible. Even when we pass on the wholesale rates to our customers (retail or wholesale) without any averaging, although TalkTalk Group does not bear any risk of flip-flopping, the customer will experience (and suffer from) volatility.

Finally, it is worth emphasising that we do not see any countervailing benefits from this gaming.

Question 9.4: Do you agree with our preferred option for resolving the issue of flip-flopping – 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? You may want to include discussion of the following in your response: the specifics of each option, e.g. the 20% cap in our preferred option, the effectiveness of the options in addressing the objectives, the practicalities of the options for you, any disadvantages/adverse effects of these options for you, and any other information or views that you feel are relevant to preventing flip-flopping.

We do not agree with Ofcom's preferred option because it would be necessary and more appropriate to adopt a more transparent and stable option. We would prefer (of the options outlined) Option 4 but could also consider Option 3 as a second-best alternative. Our reasoning is as follows:

- Ofcom recognises that flip-flopping is a harmful practice that must be stopped.
- Ofcom believes that "most of the current use of time-of-day flexibility for MTRs is not designed to incentivise efficient network use" (section 9.156 of the consultation document) because there is little pass-through to retail rates. It follows that specific time-of-day rates is not necessary for the mobile operators to be able to manage their network on an efficient basis.. Maintaining a single average MTR for all times of day throughout the charge-control year (i.e. Option 4) should therefore not cause any problems for mobile operators who would still achieve their objective of maximising their allowable call termination revenue. Option 4 would also crucially provide originating fixed operators with absolute protection against the harmful effects of flip-flopping.
- In the alternative, we believe Option 3 may achieve a similar result as Option 4 although it would be less transparent (because each mobile operator could still set their individual time-of-day averages on an annual basis). Option 3 is effectively also what BT has followed since it has been subjected to price controls (and indeed what most mobile operators used to do as well before the practice of flip-flopping was "invented").

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

Yes, we believe that there is a better solution than Option 3 and, possibly, Option 4.

The underlying problem is that MNOs can game the system to get a higher average revenue because the formula used to calculate the AIC is based on using the previous year weightings. This can simply be addressed by using the 'current year' weightings rather than 'previous year'. Obviously this can only be done retrospectively and any error could be addressed by an adjustment in the following year.

This would work as follows:
- Prices in year 1 set based on year 0 traffic weightings;
- At end of year 1, AIC calculated using year 1 weightings; and

- Any difference between AIC and ATC is recovered in year 2.

This would almost totally remove any incentive to game the system since flip-flopping would be rendered nugatory.

Aside of this approach, MNOs could be given fairly wide discretion on pricing although it may be useful to have requirements on frequency and magnitude of changes.

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?

We believe it is clear which types of calls are included in the new charge control.

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

We believe that the proposed steps to monitor compliance represent an improvement on the current situation. It will become necessary to enhance compliance monitoring given Ofcom's proposals to prevent harmful "flip-flopping". We would note, however that Option 4 for stopping flip-flopping would require minimal monitoring and would also make it very easy for fixed operators to monitor compliance independently of Ofcom.

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

We believe this is a question for the MCPs so will not comment further here other than to say that the information requirements seem reasonable.

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

Yes we agree.

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.

Yes we agree with the EIA.

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