Wholesale Mobile Voice Call Termination Market Review

UKCTA Response to Ofcom Consultation

Submitted to Ofcom: 25TH June 2010

UKCTA is a trade association promoting the interests of competitive fixed-line telecommunications companies competing against BT, as well as each other, in the residential and business markets. Its role is to develop and promote the interests of its members to Ofcom and the Government. Details of membership of UKCTA can be found at www.ukcta.com.

This consultation addresses issues that have wide ranging implications for UKCTA members, members that have vastly diverse interests. This response is focused solely upon Ofcom's 2nd consultation on the Wholesale Mobile call Termination Review. The views in this response should not be read across to any other market review Ofcom may undertake in the future.

The views expressed by UKCTA in this response do not reflect the views of Orange, Virgin Media and COLT. These UKCTA members will be submitting their own responses to the consultation.

Introduction

On 1 April 2010, Ofcom published for consultation its proposals for the regulation of wholesale mobile voice call termination. Ofcom's final view will determine the MCT charges when the current price controls expire on 31 March 2011.

Ofcom's previous review (issued in May 2009) considered how MCT rates should be set when the current price controls expire and looked at a range of approaches, ranging from deregulation to bill & keep. However, Ofcom, in this consultation, are proposing not to pursue a more radical approach but to adopt the EC recommendation and use pure LRIC to set a charge control for the four national MCPs.

In summary, Ofcom's main proposals are to:

- Regulate directly the termination charges of the four MCPs which operate fully-deployed national mobile networks
- Require other MCPs to provide call termination on fair and reasonable terms
- Adopt a pure LRIC model to set the charge control
- Adopt a four-year glide path of rates which will lead to average MTRs falling from 4.3ppm in 2010/11 to 0.5ppm by 2015 (in 2008/9 prices)
- Limit the frequency and size of changes MCPs can make to their MTRs

UKCTA members generally support these proposals, although there are some concerns relating to the implementation and level of the proposed price controls. The following provides more detail on UKCTA member's views on Ofcom's preliminary conclusions.

Regulate directly the termination charges of the four MCPs which operate fully deployed national mobile networks

Having considered the responses to the May 2009 consultation, Ofcom believes that regulation of MTRs continues to be necessary, a view with which UKCTA totally agrees. This as MCPs continue to have the ability and incentive to set high MTRs and the removal of ex ante regulation would allow MCPs to charge excessively high termination prices. Ofcom states that reliance on ex post competition law enforcement would not be sufficient to provide regulatory certainty and to promote the development of competition. UKCTA members fully agree with this position and as a result also agree that some form of regulation for MCT is required for the foreseeable future.

UKCTA members fully support the finding of SMP and the ongoing direction of a charge control. As Ofcom note, in the absence of regulatory controls, the four MNOs would have both the ability and the incentive to set MTRs above a reasonable level, resulting in further imbalance of competition between fixed and mobile networks. Such behaviour would be detrimental to both competition and consumer interests. However, whilst UKCTA members support the objective of achieving a termination rate of 0.5ppm by the end of the charge control period, there are reservations over the length of time to achieve such a rate. The consequence of which is that in the meantime the UK rate may still be much higher than in other European countries and not meet the EC Recommendation. This point will be developed further under the glide path proposal.

Require other MCPs to provide call termination on fair and reasonable terms (i.e. not subject to charge controls)

Ofcom's proposals in relation to the smaller, newer MCPs are reasonable and should prove sufficient to constrain the MTRs of such providers. Accordingly, UKCTA members agree that the proposed remedies, whilst definitely necessary, are, when coupled with Ofcom's expectations that rates will be in line with the symmetrical rates applicable to the four national MCPs (backed by Ofcom's dispute resolution powers), sufficient to control the newer MCPs termination rates.

Adopt a pure LRIC model to set the charge control

On 7 May 2009, the European Commission adopted a Recommendation on the regulatory treatment of fixed and mobile termination rates in the EU. This introduced a common approach to regulation of termination rates across the EU in order to achieve greater consistency and more effective regulation of termination rates. It essentially provides that national regulatory authorities should ensure symmetric termination rates, based on the costs incurred by an efficient operator, using a pure forward looking, bottom-up, long-run incremental costs model. The Recommendation suggests that joint and common costs should be recovered from the competitive retail side of the mobile market rather than from termination charges. The impact of this approach would be to reduce the headline rate of termination charges, particularly MTRs, potentially by a significant amount.

Ofcom, like all EU national regulatory authorities, is required to take utmost account of the Recommendation.

In accordance with the above, Ofcom is proposing to adopt a pure LRIC model (also known as Long Run Marginal Cost, LRMC) to determine the appropriate charge controls when the current control period expires. UKCTA members endorse this proposal and agree with Ofcom that in the absence of any overriding UK market specific reasons, the EC recommendation should be adopted in respect of mobile termination charges.

Furthermore, whilst the current model (LRIC+) has led to numerous disputes and litigation, resulting in additional regulatory uncertainty and expense for the industry, this should not be a reason for abandoning LRIC as a means for determining charge controls. In any event, any model which relies on cost allocation methodology will be likely to encounter similar issues. Accordingly, the threat of continuing challenges and the resultant regulatory uncertainty should not be the overriding consideration in determining the mode of regulation; market conditions should be the determining factor.

The adoption of a pure LRIC model to set MTRs, thereby not allowing MNOs to recover joint and common costs of the network through the MTR, will lead to a greater decline in the level of MTRs than will be achieved if alternative models are used. Such an outcome more closely mirrors the Commission's Recommendations than other approaches.

In addition the continued application of LRIC+ would not address concerns that fixed operators are, in effect, subsidizing mobile operators as a result of high MTRs. This is due to the fact that MTRs have been set above the marginal cost of provision, a view that is supported by EU analysis which concluded that MTRs for fixed to mobile calls results in a significant transfer from fixed line customers to mobile customers.

Although the adoption of pure LRIC will have implications for the continued application of LRIC to other charge controls, this in itself should not act as a barrier. Ofcom's regulatory duties should ensure that remedies are determined based on the best outcome, taking into account Ofcom's primary obligations.

As a result of the above, the adoption of pure LRIC or LRMC for calculating mobile termination rates has UKCTA's full support. It is in line with the EC Recommendation, provides the best outcome in terms of mirroring the costs incurred by an efficient operator in terminating a call and is hence the most economically efficient model.

The adoption of a pure LRIC model will result in a significant reduction of MTRs whilst ensuring reductions in termination rates occur steadily, and in a fashion which the industry can manage.

Adopt a four-year glide path of rates which will lead to average MTRs falling from 4.3ppm in 2010/11 to 0.5ppm by 2015 (in 2008/9 prices).

Ofcom proposes to adopt a four-year glide path of rates, commencing from 1 April 2011, based on a maximum average rate calculated using the pure LRIC formula. As a result, this will result in MTRs falling from 4.3ppm in 2010/11 to 0.5ppm by 2015 (in 2008/9 prices).

It is also noted that from 2011/12, the charges for all mobile operators will be symmetrical, in line with the Commission Recommendations.

Overall, UKCTA members support these proposals in terms of the planned reduction in MTRs and the move to symmetrical rates but have some concerns over the length of time it will take to reach rates based on pure LRIC. UKCTA would urge Ofcom to review their proposal to maintain a glide path in this instance and instead mandate reductions to ensure MTRs are set in line with pure LRIC levels at the earliest possible time.

At the very least, Ofcom should provide justification for the ongoing use of implementing MTR reductions via a glide path. The EC, in its Recommendation working paper, concluded that there seems to be no empirical support that a decline in MTR will lead to increases in mobile retail prices, contrary to the waterbed theory. As such, the justification for maintaining a glide path for managing MTR reductions becomes more doubtful.

Limit the frequency and size of changes MCPs can make to their MTRs.

Ofcom are proposing to limit the frequency and size of changes MCPs can make to their MTRs. This measure will significantly limit the scope for 'flip-flopping', where rates are varied by time of day to exploit flexibility in the way that the current charge controls have been set and are implemented.

UKCTA members have been raising concerns with Ofcom in relation to 'flip flopping' for some time and are fully supportive of Ofcom's intentions. Left unchecked this practice would allow MCPs to continue to force purchasers of MCT to pay more, in aggregate, than the rates intended to be set as an upper limit. In addition, this practice also forces competing operators to incur extra costs, as the MTRs are frequently changed by significant amounts, requiring price notifications to be prepared and distributed to customers, in compliance with contractual obligations.

Clearly the practice of constantly changing rates is to the benefit of MNOs and adversely affects fixed operators, which consequently distorts the market. Ofcom must ensure that whatever measures they finally adopt to address this issue removes the opportunity and incentive for an MNO to constantly vary their rates. This could be successfully tackled by replacing the determination of Target Average Charges (TACs) and instead setting a single flat rate. Such a policy has already been implemented in Belgium, Netherlands and Spain and UKCTA would urge Ofcom to also adopt such an approach.

Furthermore, frequent price changes make it difficult for CPs to make any assessment as to whether an MNO is complying with the charge control so an effective programme for monitoring compliance with charge control obligations must be introduced. This concern would also be addressed if a flat rate MTR were set.

This is an important issue, not only for CPs but also for consumers. This as, as a result of ‘flip flopping’ CPs have little option but to set retail rates at a level to cover, to a degree, future fluctuations in MTRs. This results in potentially higher retail rates, which is to the detriment of consumers. In particular, since the impact has historically been most significant in relation to daytime rates, where charges have flipped on a monthly basis by up to 11ppm, the adverse consumer impact has been borne heavily by business users. The Determination of a flat rate would not only provide industry with greater regulatory certainty but also provide greater transparency and understanding to consumers through a simplified charging regime.