Response to Ofcom's Consultation on Wholesale Mobile Voice Call Termination

Virgin Media welcomes the opportunity to respond to Ofcom's consultation on mobile termination charges. Virgin Media is obviously in a unique position as it is one of the few operators in the United Kingdom to have both a fixed arm and a large MVNO.

Virgin Media's view is that adopting a 'pure LRIC' approach will lead to radical changes in the way in which mobile services are charged – with the likely introduction of new "fixed" or higher fees by mobile operators. Virgin Media's view is that the burden of this revised charging structure is likely to fall on prepay customers (the bulk of whom from Ofcom's own statistics) are probably least likely to be able to afford these additional charges. Generally prepay customers tend to have a usage profile skewed towards inbound traffic. If inbound revenues generated by these customers decrease, MNOs may seek to offset the decline by increasing outbound usage charges or introducing other forms of charge.

This will also lead, in Virgin Media's opinion, to a significant disruption to the markets and competitive environment. The material change in the level of MTRs that will be brought about by the adoption of pure LRIC will cause mobile operators to re-balance their business models, with a likely re-distribution of cost recovery, revenues and margins etc. It is very likely, therefore, that customers will be compelled to either give up or revise their packages and/or migrate to different service bundles as a result of wanting to maintain the best value for money service – with such activity obviously having the potential to lead to confusion and disruption.

The impact on citizens and consumers aside, a pure LRIC approach also fails to allow mobile operators to recover an adequate return on investment and is likely to dissuade mobile operators from making the necessary investments in the mobile market that will keep the UK's mobile market at the fore of competitive mobile markets across Europe.

Furthermore, we believe that the adoption of a pure LRIC approach to mobile call termination will hasten calls for fixed termination rates to be set on the same costing standard. For much the same reasons as set out in this response, we believe that the application of the pure LRIC standard to fixed termination (and indeed other charge controlled services) would be wholly inappropriate, would not be justified and would result in significantly damaging consequences for competition. The inability of competing fixed providers to make an adequate return will similarly constitute a disincentive to investment. While, in the short term, lower regulated charges may result in lower charges for consumers, this is unlikely to be sustained in the medium to longer term, as choice and competition reduce – not to mention the negative consequences for innovation and development of new products and services. While we recognise that the focus of Ofcom's consideration is necessarily framed by the relevant underpinning market and thus the direct implications of the potential approaches, Virgin Media believes that in having regard, as it is required, to its statutory duties and obligations, it is incumbent upon Ofcom to take into account the wider implications of the potential approaches to setting MTRs

Virgin Media believes that for these key reasons Ofcom is unable to justify the use of LRIC under the European Directive as implemented within the UK by the Communications Act 2003. Whilst Ofcom is required to take the utmost account of the Commission's recommendation on termination rates, Article 13 of the Access Directive is legally binding and requires Ofcom to ensure that any cost recovery serves to promote efficiency and sustainable competition and maximises consumer benefits.

Virgin Media does not believe that Ofcom's consultation document adequately addresses its requirements under the Directives or the requirements of the Communications Act. .In particular when one looks at the test under section 88 (2) of the Communications Act, Virgin Media finds it difficult to see how Ofcom can justify a move to a price control based on LRIC.

Without prejudice to its views that Ofcom cannot justify a move to pure LRIC, Virgin Media also has concerns with the way in which Ofcom has calculated pure LRIC. These are set out below.

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?

Virgin Media agrees with Ofcom's view that the MCP should have their own allocation of numbers and should control the termination rate.

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

Ofcom has identified MCPs with licensed wireless spectrum, some forms of MVNOs and other new entrant MCPs who terminate calls to mobile numbers and control the termination rate. At this point in time Virgin Media cannot identify any other types of providers who should also be considered.

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?

Virgin Media agrees with Ofcom's views on the specific call types that should be included in the market.

Question 3.4 Do you agree with our view 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?

Virgin Media agrees with this 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?

Virgin Media agrees that it is unlikely that within the forward looking period considered by this review that there will be developments that would remove the underlying causes of SMP. Virgin Media cannot see that there will be any technological developments that will result in a removal of the termination bottleneck.

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

Virgin Media has no other comments to make on Ofcom's SMP analysis.

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

Virgin Media is not aware of any other providers with SMP that have not been identified. In the interests of clarity Virgin Media would be interested in how Ofcom intends to deal with new providers who come into the market and control the termination rate to an allocation of numbers between the consultation and the final statement and after the date of the final statement.

Will these providers be free from regulation until the next market review or will Ofcom carry out a review for new providers during the course of the forthcoming price control?

Understanding the process that Ofcom intends to follow will provide certainty to Virgin Media when negotiating interconnect arrangements with any new operators who might emerge.

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

Virgin Media agrees with Ofcom's assessment of SMP for the period until 2014/2015.

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

Virgin Media agrees that excessive prices could cause harm to consumers.

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

Virgin Media has not identified any other form of consumer harm.

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

Virgin Media agrees with Ofcom's view that price transparency is necessary for all MCPs who have SMP but believes that all MCPs with SMP should be required to publish their charges and to give 56 days notice prior to any changes being made.

Virgin Media feels that a longer price notification period would be a more proportionate way of dealing with flip flopping than the methods proposed by Ofcom below. A longer period of notice that rates were going to change would allow originators to adequately respond to price changes.

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?

Virgin Media agrees with the requirement that all providers with SMP (apart from the big four) have a requirement that their charges should be on a fair and reasonable basis. This is the same situation as in the fixed world where all providers with SMP apart from BT are required to provide their fixed termination on a fair and reasonable basis.

Virgin Media also welcomes Ofcom's guidance on how it will interpret the fair and reasonable condition and its view that generally speaking, in the context of mobile call termination, symmetric rates would be fair and reasonable as between MCPs.

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

Ofcom is proposing to impose an undue discrimination condition on the big four MCPs but not on the other MCPs. Virgin Media agrees that the big four MCPs should have an ex ante undue discrimination condition applied to them. It is not sufficient to rely on ex post remedies in this situation.

However it is not clear that Ofcom's reasons for not including an undue discrimination condition on all other MCPs withstand scrutiny. Whilst Ofcom identifies that there is less likely to be harm in the retail markets from undue discrimination by smaller MCPs, its key reason for not imposing an obligation appears to be the fact that these providers have not previously had this obligation imposed upon them and Ofcom has concerns about the impact of doing so.

A provider with SMP in a market will need to be concerned about discriminatory behaviour regardless of whether there is an undue discrimination condition placed on it or not as it faces

the possibility of a Competition Act investigation for abuse of dominance for discriminatory behaviour. Given this fact Virgin Media does not see how the impact of imposing an undue discrimination condition could be seen to have an overly high impact.

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?

Virgin Media notes that the UK is required to take the utmost account of the recommendation, and where it chooses not to follow a recommendation it shall inform the Commission, giving the reason for its position.

Therefore Virgin Media believes that the appropriate question to ask is what effect would following the recommendation have in the UK and is following the recommendation consistent with Ofcom's statutory duties and obligations both under the Communications Act 2003 and also under the European Framework.

Virgin Media notes that Ofcom had considerable concerns about the Commission's draft recommendation. Ofcom itself (along with BERR) in response to the Commission's draft Recommendation stated "*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."*

It also said *"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 or impact."*

In Virgin Media's view the consultation document published by Ofcom does not provide the robust justification it itself has previously viewed as necessary for a departure from LRIC+.

Rather it seems to Virgin Media Ofcom appears to have decided to follow the LRIC approach on the basis that "*Our analysis suggests that there are merits in the pure LRIC approach as well as in the LRIC+ approach and the economic judgement on which is better is finely balanced. Therefore, 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*."

Virgin Media does not believe that this is sufficient given the mandatory requirements of section 88 (1) and 88 (2) of the Communications Act which deal with network access pricing and which provide as follows:

(1) Ofcom are not to set an SMP condition falling with s87(9) (a price control condition) except where-

(a) it appears to them from the market analysis carried out for the purpose of setting that condition that there is a relevant risk of adverse effects arising from price distortion; and

(b) it also appears to them that the setting of the condition is appropriate for the purposes of –

(i) promoting efficiency;
(ii) promoting sustainable competition;
(iii) conferring the greatest possible benefits on the end users of public electronic communications services.

(2) In setting an SMP condition falling within section 87(9) 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.

Virgin Media does not believe that Ofcom have adequately demonstrated that adopting a LRIC as opposed to a LRIC+ approach adequately satisfies these criteria.

In particular given Ofcom's inability to reach comprehensive conclusions on the likely impacts on consumers following a move to LRIC, Virgin Media finds it difficult to see how Ofcom can have reached the conclusion that a LRIC approach will confer the greatest possible benefits on the end users of public electronic communications services.

Similarly Virgin Media struggles to see how the LRIC approach adequately takes account of the requirement to have regard to investment considerations. Virgin Media notes that the requirement to have regard to investment not only applies under S88(2) but also under Ofcom's general statutory duties under section 3 which require it to have regard to the desirability of encouraging investment and innovation in relevant markets.

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

Virgin Media is strongly of the view that the proposed price cap based on LRIC proposed by Ofcom is too stringent and that Ofcom should continue with the LRIC+ model it has previously adopted in relation to mobile termination in this country.

Virgin Media notes that the move from a LRIC + to a LRIC model will result in dramatic reductions and it is not clear to Virgin Media that Ofcom has considered all of the possible consequences of moving to this model.

As Ofcom acknowledges the UK retail mobile market is one of the most competitive in the world and despite the consolidation of T-Mobile/Orange it is likely to remain highly competitive. Much of this vibrant competition can be attributed to MVNOs of which Virgin Media operates the largest although there are other large MVNOs such as Tesco and a large number of MVNOs targeted at specific customer segments.

One of the main drivers for MNOs to strike MVNO agreements is to attract more traffic to their network. As network congestion rises and the value of traffic decreases due to the rapidly declining MTR rate, there may well be less incentives for MNOs to enter into new MVNO agreements and some MNOs may consider rationalising their existing MVNO bases. This threatens to lead to a decrease in competition at the retail level with consequent impacts on consumers through removal of choice.

As set out above Virgin Media's primary concern is in relation to the choice of LRIC as opposed to LRIC +. We elaborate on our concerns against each of the criteria that Ofcom has identified as being important (see paragraph 7.113) to determine the best costing approach to adopt:

- Economic efficiency
- Competitive impacts
- Distributional effects on consumers
- Commercial and regulatory consequences.

Economic efficiency

As set out in section A12.10 of the consultation document, Ofcom has assigned greatest weight to the two criterion of economic efficiency and competitive impacts. However when one looks at the conclusions that Ofcom has reached in relation to economic efficiency, the conclusions hardly provide a compelling justification for using LRIC as opposed to LRIC +. Indeed in paragraph A12.66 when looking at allocative efficiency Ofcom states

"*to conclude we believe that on the basis of the evidence available one cannot necessarily conclude that a switch to pure LRIC possibly leading to a change retail price structure is* ***necessarily optimal****. However, observed price discrimination is high and combined with the evidence presented in annex 13 we believe it is unlikely that ownership would materially*

decline as a result of a switch to pure LRIC. Therefore although pure LRIC is unlikely to be optimal we believe that it would be efficient to recover at best, a limited amount of common costs from MTRS. Therefore, as the choice is between _two second-best options_ *(LRIC+ and pure LRIC), it is difficult to conclude that either of the two cost standards should be preferred on allocative efficiency grounds*." (emphasis added)

On dynamic efficiency Ofcom says *"we do not believe there is much difference between the two cost standards. Although in principle there is a higher risk of setting MTRs too low under pure LRIC this is likely to be countered by the presence of a waterbed effect (even though this may be incomplete).*

Given that this is one of the two criteria to which Ofcom has placed most weight, Virgin Media finds it staggering that the conclusions about the choice of LRIC are so weak.

Competitive Impacts

Virgin Media notes that Ofcom's conclusions about competitive impact (the second of Ofcom's criteria to which it attaches most weight) are equally weak and in its view unsupportive of a move towards LRIC. Virgin Media notes that Ofcom's conclusions on competitive impact are as follows:

"*We believe that a switch to pure LRIC for MTRS would ease, any* ***potential*** *concerns about competition among MCPs. However, we have not concluded that this is currently necessarily a substantial concern. In any case any concern would be reduced further as MTRS decline under either of the two cost standards examined here.*

Concerns have also been expressed about the impact that high MTRS may have on competition between fixed and mobile networks as they act as a transfer of resources from the fixed to the mobile sector. From a short run point of view the fact that we have concluded that at the retail level the two services are in separate markets ***limits somewhat such potential*** *concerns. Nonetheless, there is already strong competition for at least some call types (eg calls to mobiles) for at least some consumer groups. The adoption of pure LRIC for MTRS would therefore reduce such concerns, even if the same method was later applied also to setting FTRs***.**

Distributional effects on consumers

Virgin Media believes that applying 'pure LRIC' to set MTRs will lead to material price rises for lower usage mobile customers that typically have an inbound usage profile. [ ] **[Confidential**]

In contrast there is limited evidence to support the argument that setting MTR's on a 'Pure LRIC' basis will lead to significantly reduced retail charges for fixed to mobile calls for fixed customers. VM believes that past experience shows that to the extent that fixed operators do experience a reduction in costs as a result of lower MTRs, that reduction is always not necessarily passed through to customers **directly** in the form of reductions of fixed to mobile pricing. In Virgin Media's view Ofcom's distributional analysis does not adequately reflect this fact.

Commercial and Regulatory consequences

As Ofcom acknowledges in A 12. 106 all regulation carries the risk of error –in relation to MTRs, the risk of setting cost based termination rate either too high or too low.

In A 12.109 Ofcom acknowledges that in terms of the consequences of regulatory errors it is generally believed that erring on the upside (ie higher rather than lower charges) might be more appropriate. This is because the consequences of setting rates too high (ie deadweight loss) is considered less severe than setting them too low (ie the risk that innovation and investment may be reduced and at the extreme, if set too low, that some firms may exist or

cease to provide the service in question). From this viewpoint, pure LRIC appears riskier than LRIC +.

Virgin Media agrees with Ofcom's assessment that erring on the high side is more appropriate and suggests the statutory requirements placed on Ofcom not only under section 88 of the Comms Act but also under section 3 of the Comms Act also suggest that Ofcom should err on the high side when setting a price control.

Virgin Media feels that the risk of understating the appropriate rate and thereby affecting MNO's abilities to invest is crucial. In practical terms, on Ofcom's assessment the difference between choosing LRIC versus LRIC+ is material with the difference in 2014/15 being 1PPM. Across the large number of calls that will terminate on mobiles this is an extremely significant sum that will need to be recovered by mobile operators from other sources.

Virgin Media also notes that there is likely to be greater commercial and regulatory uncertainty arising from a move to pure LRIC than LRIC +. This will arise from the fact that the MNOs are likely to challenge:

- the basis on which charges should be set (for example: Pure LRIC versus LRIC+)
- and if Ofcom pursues 'pure LRIC', what can be legitimately recovered under the 'pure LRIC' approach.

Notwithstanding Virgin Media's arguments that Ofcom is wrong to choose pure LRIC as opposed to LRIC +, in any case Virgin Media believes that Ofcom's costing model significantly under-estimates the 'pure LRIC' of MTR's as spectrum costs have been completely excluded (see paragraph 7.115). We set out this and other objections to the way in which Ofcom has estimated 'pure LRIC' under section 9.2.

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

Virgin Media thinks that at a minimum a four year period for the SMP remedies is required but suggests that the reductions to mobile termination rates are so dramatic that if Ofcom were to proceed with its proposals a longer price control period is required in order to soften the impact of such a dramatic reduction.

As Ofcom acknowledges in para A11.4 there is a significant reduction in Ofcom's model between the costs in 2008/9 and 2009/10 reflecting Ofcom's changed assumption in the WACC for operators. This theoretical model change does not reflect the underlying economic circumstances faced by operators and Virgin Media suggests that such a dramatic step change in assumptions should be factored in over a longer charge control period.

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.

Ofcom's LRIC model does not follow the EC Recommendation on Termination Rates[1] in three key ways:

(i) Ofcom's estimate of 'pure LRIC' charges incorrectly excludes the recovery of any spectrum charges
(ii) The cost model underestimates level of traffic carried over the 2G network
(iii) The cost model has not been calibrated correctly.

[1] Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, 7/5/2009, http://ec.europa.eu/information_society/policy/ecomm/doc/implementation_enforcement/eu_consultation_procedures/explanatory_note.pdf

The result is that Ofcom has used assumptions that consistently ***underestimate*** the 'pure LRIC' cost of Wholesale Mobile Call Termination. As such, Ofcom's modelling approach is inadequate.

Each point is discussed in more detail below.

Ofcom's estimate of 'pure LRIC' charges incorrectly excludes the recovery of spectrum charges

Spectrum is a necessary prerequisite in order to carry wholesale mobile termination calls. Simply stated, without spectrum, a mobile network would not be able to terminate calls.

A 'pure LRIC' costing approach according to section 4.1 of the Explanatory Memorandum accompanying the EC Recommendation "implies the exclusion of costs which would not be avoidable if the wholesale termination service were discontinued." Taken at face value, this implies that if the cost of spectrum is avoidable then ***it should be*** recoverable under the 'pure LRIC' approach for MTR services.

Ofcom's approach to 'pure LRIC' is incorrect as the entire cost of spectrum has been excluded from the estimate of MTRs[2]. This is inconsistent with the principle of cost causation, as with no spectrum available, a call could not be terminated.

As per section 5.2.2 of the Explanatory Memorandum a clear distinction is required "between traffic- and non-traffic-related costs to ensure the appropriate attribution of those costs".

Section 5.2.2 of the EC Recommendation also states that traffic driven parts of the spectrum should be included on the basis of forward-looking opportunity costs, where possible.

The EC Recommendation sets out the following specific guidance regarding the treatment of spectrum costs: "The costs of spectrum usage (the authorisation to retain and use spectrum frequencies) incurred in providing retail services to network subscribers are initially driven by the number of subscribers, and thus are not traffic-driven and should not be calculated as part of the wholesale call termination service increment. The costs of acquiring additional spectrum to increase capacity (above the initial spectrum necessary to provide retail services to subscribers) for the purposes of carrying additional traffic resulting form the provision a wholesale voice call termination should be included on the basis of forward-looking opportunity costs, where possible".

Ofcom has assumed a MCT cost model (see section A9.6) of a "benchmark hypothetical efficient costs are generated by a network cost model built around 2x30MHz 1800MHz and 2x10MHz 2.1GHz".

Even though Ofcom accepts the point that "it is possible in theory for pure LRIC to include some contribution to spectrum costs"[3], Ofcom has failed to identify the traffic driven spectrum charges that should be allowed to be recovered under the pure LRIC approach.

The opportunity cost is defined as "the next-best choice available to someone who has picked between several mutually exclusive choices[4]". In this instance, the choice is either to buy spectrum or build more base stations to provide additional coverage. The opportunity cost in this instance needs to be evaluated as the cost of building more base stations. The opportunity cost is therefore not zero, (This fact should not be confused between the opportunity cost of buying either 2G or 3G spectrum discussed in Annex 9 Spectrum Value).

VM believes that Ofcom has failed to appropriately estimate the initial amount of spectrum that would be necessary to provide a retail voice service to subscribers. It is Virgin Media's

[2] See 'Wholesale mobile voice call termination, Market Review Volume 3 – supporting annexes', 1/1/2010, A9.3 and footnote 100
[3] See 'Wholesale mobile voice call termination, Market Review Volume 3 – supporting annexes'1/1/2010, A9.3 and footnote 100
[4] http://en.wikipedia.org/wiki/Opportunity_cost

belief that the appropriate amount of spectrum to do this for a national service is approximately 6 X 200KHz of 2G spectrum and that the rest of the spectrum should be treated as traffic driven.

VM therefore believes that Ofcom needs to reassess its inclusion of spectrum under the pure LRIC approach. Failure to include spectrum charges means that the MTR costs estimates used to set the MTR Charge Control are incorrect and too low.

The level of traffic carried over the 3G network is too high

According to the EC's approach "the model should be based on both 2G and 3G employed in the access part of the network to reflect the actually anticipated situation facing the operators".

This suggests that the amount of traffic should be set to reflect the **actual** amount of traffic actually being carried on the 3G network. VM believes Ofcom's cost model fails to accurately reflect the levels of traffic terminated on 2G and the remainder via a 3G network.

According to section A8.40 the slower rate of migration to 3G suggests that "31% of handsets were 3G-capable in Q1 2009/10". Figure 7 implies that the 2007 model figure of 44% in Q1 2009/10 has been used as the basis of Ofcom's latest projection. This therefore clearly indicates that in Q1 2009/10 that 13% more of the total traffic terminated should be assumed to be carried on the 2G network (instead of the 3G network).

This suggests that the level of MTRs costs used to set the MTR charge control are incorrect and too low.

The Cost Model has not been Calibrated Correctly

Ofcom's cost model has not been correctly calibrated to reflect mobile operators' costs and volumes of base stations. The consequence is that Ofcom has underestimated the costs of termination.

a) Volume of base stations
The "hypothetical' bottom-up modelling approach that Ofcom has adopted does not accurately capture the number of base stations that operators have deployed.

A key weakness of the bottom-up model that Ofcom has developed is that it relies upon a large number of parameters that are difficult to calibrate with any accuracy – see A10.8 for a list of some of the parameters.

This highlights the importance of benchmarking key outputs from the bottom-up model with what ;top-down' estimates that operators deployed in practice. Accurately reflecting these 'top-down' cost and volume comparisons are crucial to producing an accurate model that reflects the 'true' costs of Mobile.

Figure 24 contains the key metric upon which Ofcom's relies - 'Comparison of total macro sites between model output and 2G/3G MCP data'. Ofcom's model does not accurately capture the number of base stations actually provisioned. The slope of the model's predicted base stations has been too flat over the period 2005 to 2009.

In Q3 2009 Ofcom's model estimates 10,534 base stations when the actual figure is 10,866. This represents a shortfall of 332 base stations or 3.1%,

The significance of the flatness of the model's estimates of base stations is that in future, it will similarly underestimate the number of base stations that need to be added and therefore underestimate network operator's costs. At a minimum, we would expect the model to be set to reflect the latest count of base stations i.e. 10,866 in Q3 2009.

Paragraph A10.12 highlights the inability to calibrate other network elements and highlights the inherent weakness in Ofcom's bottom-up modelling approach and inability to calibrate it to the 'top-down' benchmarks.

b) Cost Calibration

Figure 26 indicates that GBV is the cost model is consistently lower over 2006-2008 period than was actually achieved by operators. In 2008 the GBV was £4,088M – when compared to £3,920M predicted. This is a shortfall of 4% of the total.

In addition, Figure 28 indicates that opex is the model is consistently lower over 2006-2008 than actually achieved. In 2008 the opex was £360M – when compared to £353M predicted. This is a shortfall of 2% of the total.

In conclusion we believe Ofcom's modelled 2008 GBV and Opex should be increased to more accurately reflect operator's actual costs.

Virgin Media cannot gauge the materiality of the adjustments set out above since we have not been provided with Ofcom's populated cost model. We invite Ofcom to assess the materiality of the adjustments and make appropriate increases to the MTRs.

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

Virgin Media is not clear that there is real harm caused by flip flopping provided that originators have an adequate opportunity to respond to the changes in termination rate. Virgin Media's view therefore is that rather than trying to control the number of times and the extent to which mobile operators can change their termination rates, Ofcom should concentrate on ensuring that mobile operators provide sufficient notice to originators to ensure that they are able to adequately respond to changes in termination rates.

Question 9.4 Do you agree with our preferred option for resolving the issue of flip flopping (ie charges 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 Virgin Media's response above.

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

As Virgin Media has suggested in response to questions 9.3 and 7.1 it believes that a more proportionate way of dealing with flip flopping would be to impose a longer notification period for price 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?

Virgin Media has no comment to make on this question.

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

Whilst Virgin Media welcomes Ofcom's greater transparency on how it will monitor compliance it believes that the missing element is communication to the rest of industry on the outcomes of these compliance investigations.

Virgin Media has had in the past had concerns that MNOs may not have complied with their TAC requirements. Whilst Ofcom has acknowledged these concerns and indicated that it would be carrying out its compliance investigations, the position has been that industry is only informed if Ofcom decides to take formal action.

In the interests of transparency Virgin Media requests that Ofcom should share with industry its view regardless of the conclusion that has reached. Otherwise the issue of compliance with TACs remains a black hole of information for the rest of industry. Virgin Media suggests that it would be helpful if Ofcom published the actual average charge achieved by each operator on a quarterly basis. This would allow industry to assess where each operator was compared to a theoretical linear TAC curve.

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

Not applicable.

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

Virgin Media is concerned that in carrying out its distributional analysis Ofcom has been too optimistic about the possibility of benefits being passed on to fixed line consumers whilst at the same time it has not adequately taken into account the likely impact on prepay and lower income customers of mobiles.

Virgin Media notes that Ofcom summarises the impact of lower MTRS as :

- Some people who would have multiple subscriptions will face incentives to have fewer subscriptions;
- Consumers who use fixed (and not mobile) services will be better off; and
- Consumers who use mobile (and not fixed) services may be worse off depending on how sensitive they are to changes in the prices for subscription and calls.

In addition Ofcom also concludes that **all consumers** will benefit from enhanced prospects for competition between fixed and mobile services, and fixed/mobile convergence, although importantly Virgin Media notes that Ofcom does not attempt to model these benefits and does not therefore rely on them.

Ofcom's ability to make the statement above however is dependent on Ofcom's "*critical assumption that guides this analysis is that a decline in MTRs and a further decline when adopting pure LRIC will most likely lead to lower ppm call charges (for off net mobile to mobile MTM and fixed to mobile (FTM) calls but not necessarily for on net MTM calls, but potentially higher fixed charges-these could take different forms (higher subscription charges, lower handset subsidies etc) which are difficult to predict. Therefore the structure of retail prices may change.*"

So a key plank of Ofcom's analysis is their view that charges for fixed to mobile calls will decline directly. This however conflicts with past evidence on the pass through of lower MTRs by BT in particular where it is clear that reductions have not been passed on directly in the form of lower fixed to mobile call rates.

Industry evidence indicates that while overall retail prices for fixed customers on a bundle of call types have fallen as MTRS have fallen, retail prices for fixed to mobile calls have decreased proportionally less. Indeed in its Communications Market Research 2009 Ofcom

reveals that the "**cost of fixed calls to mobiles increased by 3.9% in 2008 as the proportion of fixed line calls made to mobiles to continues to rise.**"

Despite this evidence as to past behaviour, Ofcom in Virgin Media's view optimistically reaches the conclusion in this consultation paper that "*changes in wholesale termination rates may feed into the price of fixed to mobile calls more directly in the future*."

Virgin Media is not clear on what basis Ofcom has reached this conclusion.

In relation to the impact on mobile consumers, in paragraph A13.19 Ofcom notes that there are number of ways higher charges could be implemented and it suggests that providers could;

- Charge higher monthly fees for contract users;
- Reduce handset subsidies;
- Introduce minimum spend or top up commitments for pre pay users;
- Introduce time limited credit for pre pay users pr
- Charge a flat fee for every day the phone is used.

Virgin Media agrees with the arguments raised by other mobile operators in response to Ofcom's earlier consultation that reducing MTRs is likely to negatively affect low value pre pay users. Virgin Media also agrees that many pre pay users represent are least likely to be able to sustain negative consequences in the form of higher charges.

Virgin Media notes that even H3G who supports radically lower MTRS accepts that there is a correlation between low users, pre pay and more vulnerable social groups. However H3G suggests that this does not necessarily create a cause for concern because low users may become high users as per minute charges fall. Virgin is unclear how H3G reaches this conclusion and why in the absence of a robust justification for such a conclusion Ofcom would attach any weight to this view.

As Ofcom's 2009 Communications Market Research paper makes clear "*twenty two percent of households in socio-economic group DE were mobile only in Q1 2009. This compares to just 8% of ABC1 households*." Similarly Ofcom's Consumer Experience Report 2009 indicates that

"*Households with an annual income of £11.5-£17.5K experienced the largest decline in use of landlines and subsequently the highest increase in sole reliance on mobile telephony. Just over a quarter (28%) of the lowest income bracket (up to £11.5K) live in households with access only to a mobile phone*."

In relation to mobile prepay users, some 20% are in households with incomes of less than £11.5k and 32% of all prepay users are in the DE group. In contrast only 7% of pre pay users are in households with incomes less than £11.5k and 15% are in the DE socio-economic group.

Ofcom itself acknowledges in the consultation that these figures suggests that prepay consumers are markedly more likely to belong to vulnerable groups than post pay users.

Indeed Ofcom says that "*We consider that for the purpose of this analysis those consumers with low incomes and/or belonging to socio/economic groupings D and E are likely to be most vulnerable, as these consumers will be less able to afford increases in their expenditure (even in return for better service offerings) than other groups*."

Virgin Media's analysis of its own customer base supports the view that many prepay customers are low income customers and are likely to be less able to afford increases in their expenditures.

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Virgin Media notes that Ofcom in the consultation document suggests that if there were a significant negative impact on some users from lowering MTRs this issue may be better addressed through alternative policy means and suggests for example a mandatory social tariff to ensure that mobiles are affordable for low usage subscribers.

In Virgin Media's view the suggestion that a flaw in a proposed regulatory measure might be remedied by the imposition of a further regulatory measure cannot withstand scrutiny on either a common sense basis nor on a legislative basis. Rather than waiting and introducing new regulation once Ofcom's proposals on MTRs are shown to have detrimental consequences, Ofcom should concentrate on remedying the MTR proposals now by sticking with a LRIC + approach.

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.

Virgin Media's view is that Ofcom's EIA lacks robustness. It notes that Ofcom is unable to form any definitive views on their EIA and that all that they can say is that "*the effect of changes to MTRs on consumers will depend on how mobile and fixed operators react with regard to changing retail prices. At this stage it is unclear whether the changes in retail prices we anticipate will necessarily affect any specific socio-demographic groups more than the population in general.* It then goes on to say that "*to mitigate any risk of consumer harm if we are wrong about the effect on subscription and to enable us to act quickly if we have underestimated the overall impact, we propose to produce a targeted "report cared" on mobile take up and subscriptions that would be developed to track the impact if any of these policies on a quarterly basis during the charge control.*

Having said this Ofcom concludes "*this suggests that our proposed recommendation will not have a material negative impact on race, disability and gender grou*ps".

Virgin Media is unclear how given the prior two paragraphs Ofcom can reach this conclusion. As it itself makes clear it cannot make any accurate assessment of how its recommendation will affect the relevant groups and all it can do is to suggest that it will product a report card that will allow it to observe the impact following its implementation. Such a view does not seem to support its argument that its proposed recommendation will not have a material negative impact on any particular group.