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BT/EE Response to Ofcom's

Mobile Call Termination Market Review 2018-21: Consultation

BT plc and EE Ltd

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1. Introduction and executive summary

BT/EE welcomes the opportunity to comment on Ofcom's Mobile Call Termination (MCT) market review consultation proposals published on 27 June (the "Consultation"). There are a number of positive initiatives in Ofcom's proposals. In particular, BT/EE supports:

- Ofcom's light-touch approach taken in the review including in relation to cost modelling where Ofcom has taken the MCT 2015 modelled LRIC outputs to calculate the Mobile Termination Rates (MTR) cap for the period 2018-2021, an approach which has considerably lessened the regulatory burden of this market review process;
- the continuation of the pure LRIC cost standard approach (in place since 2013) in the exceptional case of UK MTRs for national calls to support objectives of price stability and certainty which in turn promotes investment (although see our further comments below in relation to the MTR cost standard for international calls).

While we welcome these proposals, we are concerned that Ofcom's forward-looking Consultation contains several omissions and flaws in relation to the MTR regime for international voice calls. Specifically:

- BT/EE proposes a reciprocity regime for MTRs for EEA calls if the UK leaves the EEA. This will protect UK consumers against *potentially* asymmetric bargaining power between UK and EEA operators that could lead to asymmetric MTR increases by EEA operators over the next charge control period (i.e. 2018/19 – 2020/21). BT/EE's reasoning is set out in Section 2 below:
    - MTRs across the EEA are currently subject to price caps regulated at the pure LRIC cost standard and are very low.[1]
    - If the UK leaves the EEA and loses the protection of these caps this could lead to higher asymmetric MTRs within the EEA resulting in higher UK retail prices for calls to the EEA and/or lower levels of investment in network services to the detriment of UK consumers.[2]
    - However, Ofcom does not consult on any options, reciprocity or otherwise, for protecting UK consumers in relation to EEA calls even though the UK may leave the EEA during the next charge control period, thus enabling EEA operators to raise MTRs to UK MNOs in this charge control period. In contrast, in relation to non-EEA calls, Ofcom has consulted on three options - including reciprocity (see below).
    - BT/EE sets out details of how reciprocity could work based on our understanding of the arrangements in Germany and France as well as impacts on consumer prices (See Annex 1).
    - Ofcom should therefore undertake analysis of reciprocity for EEA calls in preparation for the forthcoming charge control period given the risk that EEA MNOs raise their MTRs.
- BT/EE supports a reciprocity regime for MTRs for non-EEA calls - Ofcom's 'Option 3' – to protect UK consumers by placing UK operators on an equal footing with their non-EEA counterparts (in particular where there is *currently* significant asymmetric bargaining power with operators in many non-EEA countries and where non-EEA MTRs are already very high). BT/EE would also support

[1] The weighted average of MTRs is 0.97 eurocents across EU28. See Page 3, BEREC, Termination Rates at European level as at January 2017, 1 June 2017.

[2] Given that the UK retail mobile market is highly competitive and all MNOs are likely to be subject to the same MTR rates we consider the risk of retail price increases is the more likely consumer detriment.

Ofcom's Option 2 (i.e. exclude non-EEA calls altogether from charge control) if Option 3 was not adopted. BT/EE's reasoning is set out in Section 3 below:

- BT/EE disagrees with Ofcom's preferred option, 'Option 1', whereby the existing pure LRIC regulatory regime would be retained). Ofcom's analysis to support this finding is unduly conservative, overstates the risks and understates the benefits of a reciprocity regime. Ofcom's analysis should consider all available evidence and experience of reciprocity regimes in practice for non-EEA calls adopted by Germany, France, the Netherlands and Austria. We also note that there are 13 additional EEA countries where there is no MTR price regulation of non-EEA calls and where, to our knowledge, there has been no consumer detriment (e.g. no evidence of higher retail call prices to non-EEA destinations under reciprocity regimes – see also Annex 1).

For the avoidance of doubt, Ofcom's forward-looking Consultation does not require Ofcom to speculate on future (and uncertain) events such as whether we remain within or leave the EEA. However, there is a risk that UK consumers will lose the benefit of maximum price regulation protection under UK MTR regulation, were it to leave the EEA, and the impact of this could be felt within this charge control period. Ofcom must ensure suitable contingent arrangements are now in place through this process to avoid enduring consumer harm were such a scenario to occur.

Furthermore, Ofcom's market definition and SMP analysis does not adequately capture the significant impact of OTT competition on traditional markets for voice calls and the steady erosion of SMP in relation to the MCT service that could otherwise justify less intrusive remedies over the next charge control period and beyond (e.g. reciprocity for international calls where OTT competition from FaceTime, Skype, WhatApp and social media is fierce). Ofcom's analysis results in an unreliable finding that OTT is not a close competitive constraint for the MCT service. Specifically Ofcom has not adequately considered the competitive constraints of OTT on the MCT service by (i) not applying an empirical and suitably quantitative "small but significant non-transitory increase in price" ("SSNIP") test, the standard approach to market definition applied by competition and regulatory authorities, and (ii) not focusing sufficiently on the position of marginal customers. See BT/EE's reasoning in response to Question 3.1.

2. The need for a reciprocity regime for EEA calls

2.1 Risk of asymmetric bargaining power between EEA and UK operators

BT/EE is concerned that Ofcom has chosen not engage in the current forward-looking Consultation on options to prevent asymmetric bargaining power permitted by other member states against non-EEA operators, putting UK consumers at a significant disadvantage to their EU counterparts, were the UK to leave the EEA in the course of this charge control period. Specifically we consider Ofcom has missed an opportunity to consult on a reciprocity regime to give equal bargaining power to UK operators and thereby to protect UK consumers in the event that the UK leaves the EEA and loses the protection of wholesale MTR price cap regulation for calls from the UK to the EEA. It would be prudent and reasonable for Ofcom to do so at this stage, given the distinct possibility that the UK leaves the EEA during the next three-year MTR charge control period (i.e. 2018/19-2020/21), with the resultant opportunity for EEA-based MNOs to increase their MTRs to UK MNOs who would have limited bargaining power to oppose this. BT/EE notes that where UK operators currently have limited bargaining power (e.g. between the UK and non-EEA countries) we have observed very high asymmetric MTRs. This provides Ofcom with a clear counterfactual of the likely risk of retaining the current MTR regime for EEA calls if the UK leaves the EEA. Having made frequent representations to Ofcom on this risk including in our 17 November 2016 confidential submission we were surprised that Ofcom did not set out the issue properly and address it fully.[3]

Whilst it remains premature to anticipate the impact of the UK's departure from the EU will have on MTRs charged by EEA MNOs on UK MNOs, there is a significant chance that the UK leaves the EEA and loses the benefit of wholesale MTR price cap protection for calls from the UK to the EEA. Under this "change" scenario we believe Ofcom must plan ahead and preferably prior to this scenario taking effect.

BT/EE considers it reasonable, proportionate, pragmatic and realistic to form the regulation in a way which is robust to such an outcome. The alternative of only addressing this issue once the outcome is certain represents a significant risk to consumers, as explained below, which makes such a wait and see approach less effective.

Ofcom should consult now on a reciprocity regime to protect UK operators and consumers, so that it is ready to implement promptly and without exposing customers to undue risk of detriment if the UK leaves the EEA during the charge control period.

2.2 What is the rationale for a reciprocity regime and how would it work in the UK?

If the UK leaves the EEA, reciprocity could ensure that if EEA counterparties seek to raise their MTRs for calls from the UK to the EEA first - above their current low levels - then UK operators should have equal countervailing buyer power[4] to potentially respond by raising UK MTRs to match the level of the

[3] BT/EE notes that Ofcom's analysis in Section 4 and Annex 11 of the MCT Consultation is concerned with reciprocity for non-EEA calls - and not EEA calls - where there are likely to be different initial conditions, competitive dynamics and consumer impacts.

[4] Ofcom could give further consideration to an application of game theory to predict possible outcomes for consumer welfare under a reciprocity regime For example, Ofcom could identify whether a rational profit maximising EEA mobile operators' best response is to continue to charge their EEA/UK counterparty LRIC based MTRs under a reciprocity approach - especially if raising MTRs results in the operator then facing higher reciprocal MTRs themselves

counterparties new higher MTR. We believe that this reciprocity approach is more likely than other approaches – including do nothing – to deter such behaviour and incentivise a stable forward-looking equilibrium and a continuation of the current low LRIC MTRs between UK and EEA MNO counterparties to support sustainably low retail prices and continued investment for UK consumers.

To be clear, a reciprocity regime for EEA calls is not for the purpose of allowing UK operators to unilaterally raise MTRs for calls from the EEA to the UK. On the contrary our proposed approach would simply place UK operators on an equal footing with their EEA counterparts on a reactive basis if and only if EEA operators move first to increase their MTRs above the regulated EEA MTR cap rates. This will in fact make it less likely that the price of calls, by either counterparty, will rise and thereby protect the UK consumer interest.

Alternatively, BT/EE could support an alternative approach to exclude EEA calls from the charge control entirely (9 other EEA countries currently take this approach).

2.3 Ofcom should consult on guidance for a material adverse change for EEA calls

BT/EE disagrees with Ofcom's current approach which appears to be to wait until the Government announces that the UK is leaving the EEA before developing and consulting on a response plan. Given that Ofcom is already assessing countervailing buyer power options to mitigate high non-EEA MTRs through reciprocity regimes, Ofcom should ensure that its analysis of reciprocity for EEA calls is aligned with any similar regime for non-EEA calls in the current Consultation to minimise potential inconsistencies in reasoning and approach which would be inappropriate given the similar circumstances. It is therefore reasonable and prudent for Ofcom to plan now so that it is ready to act during the next charge control period.

Moreover, UK operators will require at least a further [✂] months to make the necessary changes to wholesale interconnect billing systems to implement the new arrangements once the MCT consultation (undertaken within the review period) is finalised. BT/EE's concern is that even if Ofcom issues a supplementary consultation during the current Consultation it would only just be feasible to implement reciprocity (or other alternative arrangements) if the UK leaves the EEA in 2019. In light of the above factors Ofcom's 'wait and see' approach risks leaving UK consumers without adequate protection from asymmetric MTR increases. Given Ofcom's statutory duties to promote the interests of UK consumers we feel Ofcom must change this flawed approach and instead adopt the suggested approach below.

2.4 BT/EE proposed three step approach for Ofcom to consult on guidance

BT/EE therefore recommends Ofcom take the following steps to consult on future MTR regulation of EEA calls:

- Step 1: Ofcom should issue guidance within the next few months as part of the current forward-looking Review. Ofcom should outline options for addressing asymmetric countervailing buyer power (and asymmetric increases in MTRs) if the UK leaves the EEA and loses the protection of EEA

leading to higher retail prices, lower call volumes and lower revenues (i.e. is there a 'low MTR' and 'low retail price' dominant strategy or equilibrium under an iterated prisoners dilemma game).

maximum regulated wholesale MTR price caps. Ofcom should, at a minimum, consult on the following options:

  - a reciprocity regime for EEA calls, and
  - excluding EEA calls from the LRIC charge control.

- Ofcom should be able to conduct a short consultation with stakeholders of 6 weeks.
- Step 2: Following the consultation Ofcom should set out in its 2018 MCT Statement (expected to be published in early 2018) guidance on how it would expect to act in relation to MTRs in the event that the UK leaves the EEA during the next charge control period (2018/19 – 2020/21).
- Step 3: If the UK Government announces that the UK is leaving the EEA, Ofcom should promptly form the regulation taking a reasonable, proportionate, pragmatic and realistic approach.
- The Ofcom proposals would ideally become effective on the date that the UK officially leaves the EEA (note the date the Government announces the UK will leave the EEA will be made before the UK formally leaves the EEA). What is more, industry would be clear about the consequences in that scenario and could plan and invest accordingly.
- As Ofcom will have already consulted on the options in advance of the UK leaving the EEA the necessary changes to the MTR regime can become effective at the point the UK leaves the EEA (and not after, which risks failing to prevent asymmetric MTR increases).

2.5 Ofcom's approach does not protect or promote the interests of UK consumers

The commercial reality is that UK MNOs may need flexibility to exercise countervailing buyer power before the UK leaves the EU, not after. If UK operators cannot exercise a credible threat of reciprocal MTRs immediately at the point the UK leaves the EEA, EEA MTRs payable by UK operators may spike suddenly and thereafter ratchet up overtime so that it could take years to negotiate EEA MTRs back down to the current (or lower) levels if this flexibility provided by reciprocity is delayed until after the risk has materialised. There is therefore a real and lasting such hysteresis effect which will lead to real harm to UK consumers.

In the interim, and with no Ofcom plan in place, higher EEA MTRs are likely to put upward pressure on retail prices for UK consumers:

  - EE has a range of IDD call packs and add-ons that offer consumers cheap international calls which are priced from 1-10ppm and include calls to destinations within the EEA (noting the EU28 average MTR cost of 0.97 eurocents – see footnote 1).[1]
  - [✂].
  - Higher EEA MTRs could put upward pressure on retail prices for these consumer and could also impact on the competitiveness of IDD offers compared to low or zero price OTT offers and could significantly undermine BT/EE's ability to compete with OTT providers.
  - [✂].
  - Clearly any material increases in EEA MTRs will have the effect of raising the cost base of UK operators and result in direct welfare transfers from the UK to EEA which could then be used by

[1]Details on EE's International IDD packs can be found at the following link: http://ee.co.uk/help/add-ons-benefits-and-plans/call-or-going-abroad/calling-abroad-from-the-uk.

EEA operators to subsidise their own IDD call services. This negative financial impact should also be considered in Ofcom's cost benefit assessment (i.e. both UK producer and consumer welfare transfers to the EEA).

3. Asymmetric bargaining power between non-EEA and UK operators

Ofcom's approach is unduly conservative, implicitly overstating the potential risks based on theoretical arguments and understating the potential benefits of a reciprocity regime. Ofcom's analysis also does not consider in any great detail available evidence and experience of reciprocity in practice and alternative MTR regimes for non-EEA calls. This section addresses the analysis in Ofcom's Annex 11 and as summarised at paras 4.70-4.74. Our comments are set out under the following headings:

- limited real world evidence of detriment, and
- Race to the top – pricing outcomes for bilateral negotiations.

3.1 Limited real world evidence of consumer detriment

Ofcom's Annex 11 includes a range of hypothetical and speculative analyses which are effectively given a 100% weighting when making its finding that the risks of a reciprocity regime outweigh the benefits. We think this over reliance on a hypothetical analysis is flawed. Ofcom gives no weighting to the empirical evidence within EEA countries that have adopted alternative arrangements for non-EEA calls and where, to our knowledge, there has been no customer detriment in relation to the following countries:

- Reciprocity regimes for non-EEA calls adopted by <u>four countries</u>;
- Exclusion of non-EEA calls from the charge control in <u>nine EEA countries</u>;
- Exclusion of non-EEA calls from market definition in <u>four countries.</u>

Whilst Ofcom has sought insight from other National Regulatory Authorities (NRA), via a questionnaire, its analysis contains limited information from this research. Ofcom itself highlights the need for evidence in paragraph 4.71 of the Consultation. This suggests that Ofcom would benefit from further evidence from stakeholders to support its provisional findings that the risks of a reciprocity regime outweigh the benefits. As this information could provide a prediction of how alternative arrangements could protect UK operators and consumers including in the contact of EEA call, Ofcom should seek more information before reaching a final decision.

BT/EE sets out details of how reciprocity might work and market outcomes based on our understanding of the arrangements in Germany and France in Annex 1.

3.2 Race to the top – pricing outcomes for bilateral negotiations

There is a clear incentive for BT/EE to seek to negotiate down counterparty MTRs (which are an input cost to retail prices) and pass these savings through into lower retail prices for customers. Lowering our retail prices would in turn encourage higher IDD call volumes and revenues. Given the substitutability of IDD calls with OTT, a strategy to negotiate counterparty MTRs upward would not make commercial sense since this higher MTRs would lead to a further loss of IDD call volumes and revenues as customer switch to free OTT voice calling, lowering retail and wholesale call revenues.

These factors suggest it would not be profit maximising for UK operators to simply raise MTRs in a 'race to the top' since this would lead to lower retail call volumes.

BT/EE notes that BT plc argued for reciprocity for non-EEA calls to fixed numbers in our FNMR response of 27 March 2017 (see paragraph 5.22).

4. BT/EE specific comments and responses to consultation questions

Question 3.1: Do you agree with our view of the relevant market and assessment of significant market power? If not, please explain why.

BT/EE disagrees with the relevant product market definition and assessment of SMP for the following reasons.

Product market - OTT

BT/EE maintains that MCT should be considered as part of a wider competitive mobile services market, and therefore does not agree with Ofcom's proposed market definition. Irrespective of Ofcom's conclusion on this point, however, of particular concern to BT/EE in the context of the Consultation is Ofcom's failure to recognise properly the importance of the evolving competitive constraint posed by OTT services – in particular OTT voice services – for the purposes of its market definition analysis and market power assessment.

In respect of market definition, BT/EE considers that Ofcom has wrongly excluded OTT voice services (and potentially also other OTT services, such as messaging services) from the market as a result of several errors in its analysis.

Specifically Ofcom has made an error of approach in assessing the relevant retail product market by (i) not applying an empirical or quantitative "small but significant non-transitory increase in price" ("SSNIP") test, the standard approach to market definition applied by competition and regulatory authorities, and (ii) not focusing sufficiently on the position of marginal customers. In consequence, Ofcom has adopted an unduly narrow market definition on the basis that there are some groups of (non-marginal) customers who would be unable or unwilling to switch in response to a price rise.

In consequence, Ofcom's market definition and SMP analysis does not adequately capture the significant impact of OTT competition on traditional markets for voice calls and the steady erosion of SMP in relation to the MCT service that could otherwise justify less intrusive remedies over the next charge control period and beyond. This is particularly important in relation to reciprocity for international calls where OTT competition is fierce (see below).

BT/EE believes that Ofcom's current conclusion that OTT services do not form part of the relevant market is not substantiated. Irrespective of the outcome, and to ensure that Ofcom's market definition conclusions and any significant market power ("SMP") conditions imposed by Ofcom as a result of its market review are objectively justifiable and proportionate as required by the Communications Act 2003 ("the Act"), further analysis is therefore required. This is likely to reveal that OTT services will potentially become a sufficient constraint to traditional mobile voice services over the duration of the charge control period justifying less intrusive remedies over the next charge control period and beyond.

International calls

OTT calls (e.g. FaceTime, WhatsApp and Skype) are clear substitutes for international calls to the UK. For example, Analysis Mason (AM) reports that up to the end of 2015 OTT was in fact mainly used for international and video calling, noting this would change going forward to include greater substitutability of OTT with national calls over the forecast period 2016-2021:

> *"VoIP services have been largely limited to niche use cases (such as international calls and videocalling) in Western Europe. We estimate that OTT voice penetration of smartphones was less than 30% at the end of 2015.*
>
> *We expect OTT voice usage to become normal for many app users as the user experience improves and the service becomes better integrated into apps and operating systems. Service penetration of smartphones is forecast to increase to 56% by 2021. Average minutes of use (MoU) will also increase, as OTT voice replaces some domestic usage."*[5]

For this reason, it is entirely possible that a SSNIP in UK MTRs could result in sufficient substitution from international calls to OTT to render such a Hypothetical Monopolist (HM) price increase unprofitable over the period of the next charge control. In the Consultation Ofcom states:

> *"OTT usage is far more prevalent for making international calls".*[6]

UK and international MNOs offer very competitive international calling deals (in some cases as cheap as 1ppm).[7] In these cases a SSNIP of 5-10% could potentially place OTT calls in the same market for international calls. BT/EE notes that at least four EEA member states exclude at least some international calls from the MCT market definition.[8]

Given substitution between international calls and OTT is likely to be even greater than for national calls – due to differences in competitive conditions - Ofcom should undertake a quantitative SSNIP test both jointly and separately for national and international calls to determine whether the product market includes OTT.

Prepay calls

In the Consultation Ofcom identify PAYG customers as potentially sensitive to a price increase:

> *The group of consumers which is most likely to face a non-zero marginal price for making voice calls to mobiles (such as pre-pay consumers) are those consumers who are least likely to make use of voice calls using an OTT service.*[9]

However, Ofcom then makes the following claim:

> *"14% of pre-pay consumers have made use of OTT video calls;"*[10]

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[5] Analysis Mason, COMMUNICATION SERVICES: WORLDWIDE TRENDS AND FORECASTS 2016–2021, published 2016. Estimates and forecasts are for Western Europe.

[6] Ofcom MCT Consultation, paragraph 3.24.2

[7] EE offers very competitively priced international calls. For example, the "International (50 countries)" gives customers 1,000 minutes to call 50 selected destinations around the world from the UK (including EEA destinations). The monthly cost is £10 (i.e. 1p per minute) over a 24-month period. http://ee.co.uk/help/add-ons-benefits-and-plans/call-or-going-abroad/calling-abroad-24-month-pack.

[8] Countries include Estonia, Denmark, Luxembourg and Poland. Ofcom MCT Consultation, Table A11.1

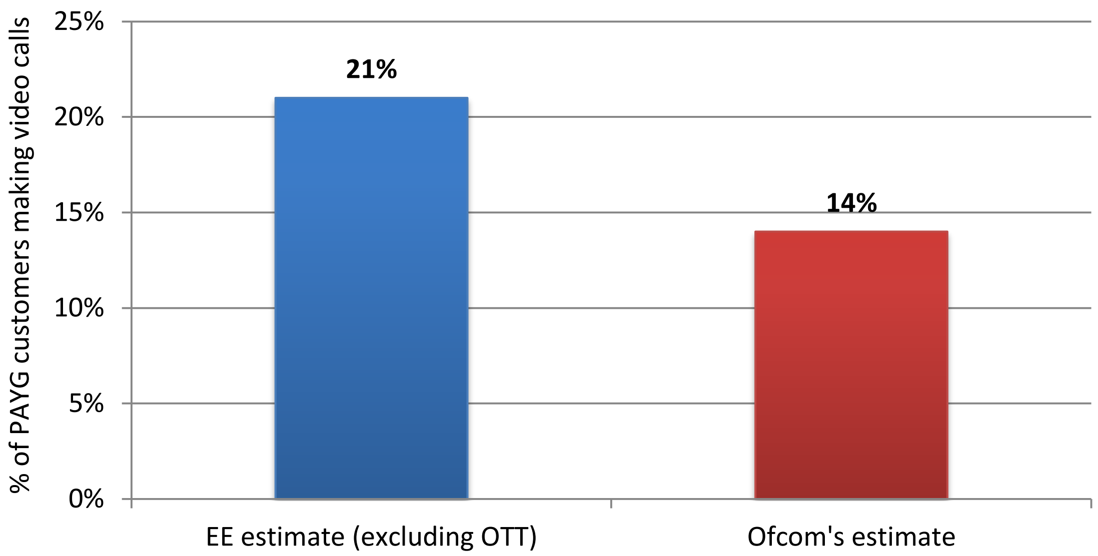
[9] Ofcom MCT Consultation, paragraph 3.24.1

Ofcom uses this result to suggest that price-based substitution may be unlikely for PAYG customers.

We have two concerns with this flawed approach. First BT/EE notes that our own internal consumer research suggests a higher penetration of OTT services for EE PAYG customers than estimated by Ofcom.

For example, EE's market sizing survey suggests 21% of PAYG consumers made video calls using 4G alone (excluding OTT calls) in the last month which is higher than Ofcom's reported 14% who make video calls.[11] Clearly we would expect both percentages would be even higher if OTT voice was included.[12] We note that customer survey results must always be interpreted with care since OTT is not a term consumers would necessarily be familiar with and in some cases consumers may not even be aware they are making OTT calls (e.g. Facetime and iMessage are so integrated into the mobile handset iOS many people will not realise these are fundamentally different ways of delivering the call/message[13]). This means that survey results will often tend to <u>understate</u> the extent of OTT voice calling.

Figure 1: PAYG customers making video calls



Secondly, and more importantly, Ofcom's 14% estimate only reveals how many consumers use OTT given the current prices. The estimate says nothing about the customer price elasticity of demand and what proportion of PAYG customers would use OTT in face of a SSNIP and whether this would render the HM price increase unprofitable. That is the measure directly relevant to the SSNIP test which Ofcom has failed to undertake. As such, Ofcom has not properly focused on the marginal customers that would likely substitute away to OTT voice services in response to a SSNIP. Given that there is strong qualitative evidence of substitution from PAYG calls to mobiles to OTT, Ofcom must undertake a quantitative SSNIP test including OTT.

[10] Footnote 50
[11] Footnote 50.
[12] We note that Ofcom report that this percentage increases from 14% to 16% when OTT voice is included. EE does not have an equivalent estimate that includes video calls and/ or OTT volumes calls at present. See Ofcom footnote 50.
[13] EE market research, 2017.

PAYM calls to mobiles made in-bundle

While it is the case that most traditional PAYM calls to mobiles are made within call allowances (94% according to Ofcom),[14] and where the incremental price of these calls is zero, Ofcom should not simply dismiss the relevance of a SSNIP test particularly where variants of a SSNIP test could be informative to answering the relevant market definition test.

For instance, the GSMA and ETNO propose a variant of a SSNIP test in their responses to the European Commission (EC) review of the EU SMP guidelines including a hypothetical "Small but Significant, Not-transitory Decline of Quality" test. For example, the GSMA states:

> *"When considering the degree of substitution between mobile communication services and services offered by the OTTs, the HMT test should therefore evolve and integrate, where relevant:*
> - *Other competition parameters like a change in quality (SSNIQ or SSNIC tests, as proposed by some authors, could also be included in the Guidelines)*[15]

BT/EE believes the SSNIQ variant of the SSNIP test should be given consideration by Ofcom for in bundle calls to mobile with a zero-incremental price. For example, if a HM de-prioritised voice so that carrier grade calls would no longer be guaranteed either end-to-end during the busy hour and/or at the cell edge would this likely result in substitution to OTT services and act as a constraint on the MCT service?

In addition, any assessment of appropriateness and proportionality of remedies should take into account the sum total of all competitive constraints, including those which arise from outside the relevant market. This includes for example OTT messaging, email and messaging on social messaging including Facebook. As the European Commission has recently noted, indirect competitive constraints on wholesale products stemming from the underlying retail market should be taken into account when assessing the existence of SMP and/or appropriate SMP remedies even where they may not be sufficient fully to constrain pricing to competitive levels.

In summary BT/EE does not believe that Ofcom adequately captures the significant impact of OTT competition on traditional markets for voice calls and the steady erosion of SMP in relation to the MCT service that could otherwise justify less intrusive remedies over the next charge control period and beyond:

- Ofcom has not undertaken adequate empirical analysis in relation to the vast majority of calls to mobiles made in-bundle on PAYM plans (roughly 94% of all calls to mobiles) and where a SSNDQ test could be informative as to where OTT substitution constrains pricing of the MCT service.
- In relation to PAYG calls Ofcom has provided some information but it is not directly relevant to the SSNIP test which Ofcom omits from its analysis. Finally, there is a clear argument that international calls may in fact be in a separate product market to national calls due to differences in competitive conditions and we urge Ofcom to undertake a traditional SSNIP test for these types of calls.

Product market - (international) call forwarding

BT/EE supports Ofcom's proposal to change the definition of a mobile services in the National Telephone Numbering Plan (NTNP). These changes would be designed to make clear such numbers should not be used to identify immobile apparatus and for conveying signals to that apparatus, effectively requiring call forwarding services to be offered on alternative number ranges. In many cases, the MCT provider that

[14] Ofcom MCT consultation, paragraph 3.23.

[15] GSMA response of 26 June 2017 to the EC's Public Consultation on the Review of the Significant Market Power (SMP) Guidelines.

offers a "call forwarding service" terminates the call to the call forwarding switch, which then originates a separate call to the final destination. Offering these services on the mobile services number range, can lead to consumer confusion and undermine consumer confidence in the mobile number range. BT/EE also notes that there has been ongoing arbitrage activity on certain 07x number ranges which has led to considerable financial out payments to call forwarding or revenue share services which further undermines the reputation of mobile number range.

BT/EE notes that call forwarding services are better suited to alternative number ranges and notes Ofcom has previously supported call forwarding services moving to such number ranges:

> *"We note that the National Telephone Numbering Plan includes other number ranges [other than 07x] that are more suitable for the provision of forwarding services – of which international call forwarding is but one example."* [16]

Geographic market

BT/EE <u>supports</u> Ofcom's proposals for the scope of the geographic market definition to relate to the area (i.e. an MCT provider's relevant handover points) for which the MCT provider can determine the MTR in relation to its allocated UK mobile numbers. This area lies within the UK. We note that this also means, for example, that calls to relevant UK numbers allocated to MCT providers in the Channel Islands and the Isle of Man would, to the extent that they provide termination services to those numbers in the UK, fall within Ofcom's proposed market definition.

Question 4.1: Do you agree with our assessment of the harm that could result from a lack of effective competition in MCT markets?

See BT/EE's reasoning in Section 2 and 3 and our response to Question 3.1 and 4.5.

Question 4.2: Do you agree with our assessment that ex post competition law alone would not be sufficient to address the competition problems we have identified, and that therefore ex ante regulation is required?

BT/EE considers that it is incumbent upon Ofcom to undertake further analysis to determine the extent to which OTT services exercise a competitive constraint on mobile voice calls, and therefore impact upon mobile operators' market power in MCT. BT/EE also believes that this should be kept under review by Ofcom given the rapid pace of change in the relevant markets, including by regularly updating its empirical analysis between review cycles.

Question 4.3: Do you agree with our proposal to impose an obligation to provide network access on reasonable request on all MCT providers with SMP? If not, please explain why.

BT/EE agrees that a requirement to provide network access on reasonable request is appropriate where a MCP is found to hold SMP.

Question 4.4: Do you agree that our proposal to impose a charge control on all MCT providers with SMP is appropriate? If not, please explain why.

BT/EE <u>supports</u> a continuation of the current maximum MTR price cap regulation regime on MCPs with SMP, where such SMP can be appropriately demonstrated.

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[16] Ofcom, MCT Statement 2015, paragraph 3.110.

Question 4.5: Do you agree with our proposal that LRIC should continue to be the appropriate cost standard? If not, please explain why.

International calls

BT/EE disagrees that pure LRIC is the correct cost standard for the wholesale MCT service for calls originating from outside the EEA. See our reasoning in Section 3.

National calls

In relation to the termination of calls from within the UK, the wholesale MCT service has features that are similar in some respects to other charge controlled SMP services. For example, LRIC+ based MTRs can be expected to promote (static) allocative efficiency objectives.

However, there are other significant mitigating factors that distinguish the wholesale MCT service from other charge controlled services, particularly given how rapidly retail mobile prices and structures have had to adapt to competition (OTT), technology (VoLTE/VoWiFi), changes in network costs and MTR regulation.

The current pure LRIC approach to setting MTRs has now been in place since 2013 and in the exceptional case of UK MTRs for national calls can support objectives of price stability and certainty which in turn promotes investment.

Question 4.6: Do you agree with our proposal to apply the charge control to all calls, including those originated outside the EEA? If not, please explain why.

BT/EE disagrees that pure LRIC is the correct cost standard for the wholesale MCT service for calls originating from outside the EEA.

See our reasoning in Section 3.

Question 4.7: Do you agree with our proposal to remove the non-discrimination obligation on the four largest mobile providers? If not, please explain why.

BT/EE supports Ofcom's proposal to remove the no undue discrimination SMP condition in relation to the wholesale MCT service. This obligation was originally intended to limit the largest MCPs from price discriminating between M2M traffic and traffic originated from fixed CPs where this could distort pricing, consumption and competition between fixed and mobile voice calls. Developments in the UK communications industry have lessened the need for such an obligation over time. Importantly removing the no undue discrimination condition would benefit all operators by supporting greater flexibility in pricing and setting bundles (with competition law providing appropriate protections) e.g. through efficient cost recovery and volume expansion which are well established benefits of bundling. As such the default should be no regulation to allow these benefits, noting that there is no longer a need for this additional regulatory intervention/protection given that the original need for it has fallen away.

Question 4.8: Do you agree with our proposal to remove the price transparency obligation on all MCT providers with SMP? If not, please explain why.

BT/EE supports Ofcom's proposal to remove the price transparency SMP condition in relation to the wholesale MCT service.. MCT providers will be required to provide Ofcom with this information within a month of the charge control year finishing and, if they fail to provide it, Ofcom should be able to take enforcement action.

Question 5.1: Do you agree with our proposed modelling approach as discussed in Section 5, the supporting annexes and the 2017 MCT model? If not, please discuss the specific proposals that you disagree with.

BT/EE supports Ofcom's broad approach to run sensitivities around the key input parameters of the MCT 2015 cost model and simply make adjustments to convert the model outputs into 2015/16 prices. BT/EE agrees that this represents a proportionate approach which minimises the regulatory burden of the market review process.

In relation to Ofcom's proposed pre-tax, real WACC for an average efficient mobile provider:

Corporate tax rate

In deriving its pre-tax, real WACC Ofcom uses a corporate tax rate of 17%. Ofcom uses this tax rate on the basis of HM Treasury's announcement in its March 2016 Budget that it expects to reduce the current corporate tax rate of 19% to 17% on 1 April 2020. Ofcom also explains that this is consistent with the corporate tax rate it has proposed in its 2017 WLA consultation.

In the Consultation Ofcom is not proposing to implement a glide path MCT rate over the charge control period and therefore the relevant consideration should be the corporate tax rate the HEO is likely to face over the whole period. Ofcom's proposal fails to take account of the fact that in two of the three years of the proposed charge control period, the corporate tax rate is expected to be 19%.

Furthermore, whilst HM Treasury has set out plans to reduce the corporate tax rate in April 2020 this proposal is not binding and is subject to change. For example, HM Treasury announced in its Summer 2015 budget that it planned to reduce UK corporate tax rates to 18% from April 2020, but then less than 12 months later revised the tax cut to 17%.

Given this uncertainty there is a clear case for Ofcom to adopt the current corporate tax rate of 19%, or at least a blended average of 18.3% (reflecting the average rate over the charge control period). We note that in the context of setting annual licence fees for 900 and 1800 MHz spectrum Ofcom effectively used a blended average corporate tax rate to calculate the Tax Adjustment Factor ("TAF") and the discount rate.

Adopting a corporate tax rate of 18.3% increases the Ofcom's pre-tax, real WACC estimate to 7.1%. If Ofcom were to take a truly conservative approach by applying a tax rate of 19% the WACC would be 7.2%.

Other Market Parameters consulted on as part of the 2017 WLA review

For BT/EE's views in relation to other Market Parameters which Ofcom has read across from its 2017 WLA's consultation, we refer Ofcom to BT's response to that consultation. [17]

[17] BT's response to Ofcom's consultation document on the "Wholesale Local Access Market Review", 19 June 2017

Annex 1: Reciprocity regime for non-EEA calls in Germany and France

Germany

The legal basis for reciprocity can be found in the Remedies Decision of BNetzA of August 30, 2016, second paragraph.

Cullen International provided the following description:

> *"The draft decisions also contain a new wording to deal with the problem of calls from countries outside the EU that apply overly high MTRs. Many countries outside the EU apply different MTRs for national and international calls and European operators want to do the same for calls from those countries.*
>
> *Whereas most EU regulators (Table) have fully deregulated calls from outside the European Economic Area (EEA) – and Austria even proposes to introduce discrimination within the EU (Flash) – BNetzA sticks to its approach that discrimination should only be allowed in narrowly defined exceptional cases.*
>
> *In the last round market analysis BNetzA mentioned these possible exceptions only in a chapter of the argumentation (Update). Now, BNetzA proposes to include the rule in the legally binding part of the remedies.*
>
> *The principle will remain the same as in 2012.*
>
> *BNetzA will not deregulate the prices. The regulated MTRs apply to all calls, wherever they originate.*
>
> *BNetzA instead allows mobile operators to refuse mobile termination for calls from selected countries. However, it must be possible to call the subscribers in the mobile network, for example via a bundled transit service of the terminating operators' fixed branch.*
>
> *Such a bundled transit service accepts all incoming calls, may they be directed to fixed or mobile numbers. As it is a transit service and not termination, its prices are unregulated.*
>
> *BNetzA wants to maintain some administrative burden in order to keep the number of exceptions small. Operators are not allowed to decide by themselves to refuse termination for calls from a certain country. This remains a decision of BNetzA, for example in a procedure to amend the reference interconnection offer.*
>
> *However, under the proposal it would be sufficient that one operator applies for such a decision. If BNetzA found that a non-EEA country discriminates between national and international calls, the other MNOs and MVNOs could also make use of this finding.*
>
> *Under the current regime, only E-Plus and Telefónica applied to amend their reference interconnection offers (Update) and BNetzA allowed them to refuse termination for calls from Morocco, Russia, Serbia, Turkey and Ukraine (and originally also Croatia, before Croatia joined the EU). Telekom, Vodafone and the MVNOs have never applied for a similar decision."*

France

BT/EE understands that ARCEP allows MNOs to differentiate MTRs for calls from outside the EU although this is not obligatory. BT/EE is aware of at least one MNO that applies a uniform surcharge for all non-EU countries in order to simplify the implementation in the billing systems. In the majority of cases the MNO's MTR is lower than the MTR applied in the non-EU country. If it exceeds the non EU MTR – a retaliation mechanism can be applied by the counterparty MNO in the non-EU country.

BT/EE also notes that the same MNO's non–EU MTR level has remained constant over time and has not impacted the retail prices for outgoing calls of the MNO's customers. In addition the MNO did not observe significant changes in calling patterns or inbound call volumes with the introduction of the surcharge.