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Three's response to Ofcom's Mobile Call Termination Market Review Consultation

1. Please see below for Three's response to Ofcom's consultation on its Mobile Call Termination (MCT) Market review, published on 27th June 2017.

2. Three supports Ofcom's finding that all UK MCPs have market power with respect to the termination of mobile calls, and its decision to impose a LRIC-based charge control as a remedy. Our response henceforth is focused on Ofcom's provisional decision to apply the same charge control cap to all calls, regardless of international origin.

Three has launched a highly competitive international calling proposition

3. Three has recently enhanced its market-leading 321 PAYG proposition to include calls to selected international destinations. Customers using the 321 tariff are now able to make calls to mobiles in selected countries at a retail rate of just 3ppm (inc VAT). Customers are not required to dial any short codes or prefixes in order to access these low rates.[1]

4. The proposition was initially launched in April 2017 to include Bangladesh, India, China and Pakistan. It was then expanded in June 2017 to cover an additional 16 countries. Table 1 below lists those countries included in the offering and the corresponding wholesale termination rates which applied at time of launch.

Table 1: Countries included within Three's PAYG 321 tariff

Country	Mobile Wholesale Termination Rate (ppm, ex VAT)[2]
Australia	[✂]

[1] See our website for further details of this proposition http://www.three.co.uk/international-calls
[2] Including any transit fees charged by international carriers

Country	Mobile Wholesale Termination Rate (ppm, ex VAT)[2]
Bangladesh	[✂]
Bulgaria	[✂]
Canada	[✂]
China	[✂]
Cyprus	[✂]
France	[✂]
Germany	[✂]
India	[✂]
Italy	[✂]
Latvia	[✂]
Lithuania	[✂]
Netherlands	[✂]
Pakistan	[✂]
Poland	[✂]
Portugal	[✂]
Romania	[✂]
South Africa	[✂]
Spain	[✂]
USA	[✂]

Note: Rates displayed are blended rates across Three's traffic to all operators within each country.

High non-EEA termination rates prevent Three from expanding this offering

5. In determining which countries to include within the 321 tariff, Three applies the following criteria:

   - [✂]
   - [✂]

6. Three has identified a number of candidate countries (see Table 2 below) that it would like to include in this proposition on the basis of [✂]. However, in common with many jurisdictions outside the EEA, the wholesale termination rates charged in these candidate countries are far in excess of [✂].

Table 2: Candidate countries Three is unable to include within its PAYG 321 tariff

Country	Mobile Wholesale Termination Rate (ppm, ex VAT)[3]
[✂]	[✂]
[✂]	[✂]

[3] ibid

[✂]	[✂]
[✂]	[✂]
[✂]	[✂]

Note: Rates displayed are blended rates across Three's traffic to all operators within each country.

7. Three is unable to negotiate these rates downwards due to a lack of bargaining power. This arises because the charge control for the termination of calls in the UK applies equally to calls originating from within and outside the EEA. UK MCPs therefore cannot credibly threaten to increase the rate for the termination of non-EEA originating calls in order to negotiate down the reciprocal rate applied to calls originating in the UK.
8. This leaves Three in a "take-it or leave-it" position with regards to the excessively high termination rates charged by MCPs in non-EEA countries. As a direct consequence, and to the detriment of UK customers, Three is unable to expand its 321 Tariff to include the candidate countries identified in Table 2 above.
9. Similarly, were there to be an enduring increase in the termination rates charged in one of the countries currently included within the proposition, it would be necessary for Three to review whether it remains sustainable for it continue to include it within the 321 tariff.

Ofcom must amend the MCT charge control to prevent further harm to UK consumers

10. According to Ofcom's own analysis, only five other regulators in the EEA apply a single mobile termination charge control cap to all calls regardless of origin.[4] Regulators in all other countries surveyed by Ofcom allow for some form of differential regulation.

11. To prevent further harm to UK customers, Ofcom must follow suit by amending the design of its MCT charge control to give UK MCPs the freedom to negotiate lower rates for calls terminating outside the EEA.

Ofcom has overstated the risks of allowing a differential MTR regime

12. In its provisional decision not to allow a differential MTR regime, Ofcom cites a concern that MCPs will negotiate reciprocally high, rather than low, MTRs. Ofcom states that both sets of MCPs in any negotiation would need to prefer low rates to high rates in order for differential regulation to lead to a low reciprocal rates outcome. Ofcom further concludes that this is unlikely to be the case.
13. In support of this conclusion Ofcom relies on the single example of a country in which an increase in MTRs for calls originating from non-EEA countries was followed by increases in rates charged for the termination of calls to these countries. However, Ofcom itself concedes that it is not possible to determine whether or not the change to the MTR regime caused this increase in rates. Ofcom therefore has no evidence of the

[4] Of which Spain has provisionally concluded that calls originating outside the EEA should not be subject to the charge control

adverse consequences it theorises materialises in practice. This is despite the operation of differential regimes being widespread across the EEA.[5]

14. Ofcom's only other empirical basis for concluding that a "race-to-the-top" in MTRs is likely to arise is its observation that UK MCPs are currently net recipients of international traffic from non-EEA countries. Ofcom states that this implies that UK MCPs would prefer high reciprocal rates to low reciprocal rates.

15. However, this narrow examination of incentives ignores the retail market impact of an MCP being able to offer highly competitive international calling propositions. The profitability associated with an increase in demand from existing customers and/or the acquisition of new customers in the retail market, may outweigh any incentive to raise rates that may exist on the basis of narrow wholesale revenue considerations.

16. Notwithstanding this point above, we also note that Ofcom's analysis of UK MCPs' incentives is only correct at an aggregate level. Actual net balances vary by country. As such there are countries [✂] for which Three would unambiguously prefer reciprocally low to reciprocally high rates (based on Ofcom's own net revenue logic). As shown in Table 3 below, Three's net revenue outflows to [✂] would be materially lower under a reciprocally low rates regime, compared to a reciprocally high rates regime.

Table 3: Comparative impact of reciprocal rates on Three net revenue position with [✂]

Outbound minutes	Outbound rate (£pm)	Inbound minutes	Inbound rate (£pm)	Net Revenue (£)	Net revenue with reciprocal low rates (£)	Net revenue with reciprocal high rates (£)
[✂]	[✂]	[✂]	[✂]	-42,874	-1,792	-34,759

Note: Volumes and rates refer to the period December 2016.

17. Ofcom's conclusion that UK MCPs would rather increase MTRs than negotiate lower rates is therefore an over-generalisation.

18. We note that Ofcom's concerns in this area could be alleviated by a regime similar to the German system by which MCPs could apply to Ofcom for permission to charge a rate to non-EEA operators above the charge control cap. This would allow Ofcom to evaluate the merits and risks a two-tier MTR based on the evidence and incentives specific to the bilateral relationship in question. Ofcom could then allow a two-tier MTR only for those countries in which the applicant has demonstrated a low risk of adverse consequences and/or a high probability of pass-through to customers.

Ofcom has overstated the practical barriers to the effectiveness of a differential regime

19. Ofcom has cited the following reasons to support why it believes a differential charge control regime is unlikely to achieve the desired outcomes:

[5] Furthermore Ofcom has dismissed the concrete example provided by Three of operators [✂] successfully using a two-tier MTR to obtain [✂].

- UK MCPs have limited ability to identify the country from which international traffic has originated;
- UK MCPs are unable to isolate the termination rate from the transit charge; and
- UK MCPs typically negotiate with international carriers rather than directly with MCPs in other countries.

20. With regards to the first point we note that at present UK MCPs have no need for the functionality to identify the origin of international traffic, as there is no scope within the regulatory regime for differential charging. Three itself would be able implement CLI-based billing at low cost should Ofcom allow it to charge a different MTR based on country of origin. Similarly, [✂] has confirmed that it is able to implement this functionality.

21. With regards to Ofcom's second point, we note that the transit charge typically accounts for a negligible proportion of the overall cost of interconnect. It is therefore unlikely to impact the ability and incentive of UK MCPs to negotiate lower termination rates.

22. Finally, in response to Ofcom's third point above, we note that a lack of direct lines of negotiation with non-EEA MCPs is again a function of the current regulatory regime. UK MCPs would have the incentive to make themselves a party to negotiations if the regulatory regime allowed them to meaningfully negotiate with non-EEA MCPs. In this regard we note that [✂] and we expect other UK MCPs will similarly be able to do so via their respective carriers.

Ofcom is wrong to conclude that reductions in non-EEA termination rates will not be passed on to retail prices

23. Ofcom has relied on the following suppositions to conclude that a reduction in terminations rates for calls to outside the EEA is unlikely to not be passed on to retail prices:

- Non-EEA termination rates are low in comparison to retail prices paid by customers; and
- Providers typically set international retail call prices for groups of countries such that a reduction in the termination rate for one country will have limited impact on retail pricing of group as a whole.

24. The evidence provided on Three's 321 international calling proposition (see paragraphs 3-18 above) shows that termination rates account for a material proportion of retail prices. For example, the wholesale rate for calls to [✂] accounts for 78% of the retail price under the 321 tariff, while the wholesale rates for calls the candidate countries in Table 2 are between 2-6 times larger than the retail rate of 3ppm that Three would seek to charge under the 321 proposition. Ofcom's claim that rates are low in comparison to retail prices is therefore demonstrably incorrect.

25. The evidence submitted with regards to the 321 plan also shows that the decision on whether to include a county within the 321 tariff (and therefore the decision to set a low retail price) is taken on a country-by-country basis. Ofcom's claim that providers set

international retail call prices for groups of countries is again another over-generalisation.

26. For these reasons we believe there is likely to be strong pass through of negotiated reduction in the cost of non-EEA termination to UK retail prices for Three customers.