Three's response to Ofcom's Wholesale Voice Markets Review 2021-26

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Executive Summary.

This is Three's response to Ofcom's Wholesale Voice Markets Review 2021-26 Consultation.[1] Shortly after Ofcom published its Consultation, the European Commission published proposals for Union-wide Fixed Termination Rates (FTRs) and Mobile Termination Rates (MTRs).[2] Importantly, the European Commission's proposals give two possible routes for UK operators to benefit from these TRs, which we consider has a significant bearing on Ofcom's proposed regulation of FTRs and MTRs (for calls from EEA operators).

We understand the European Commission will publish its decision in late 2020 and that Ofcom is planning to publish its Statement in Q1 2021, i.e. by the end of March 2021. We urge Ofcom to publish its Statement as soon as possible, as we will require several weeks to implement any changes (such as reciprocity for non-EEA and potentially also EEA calls).

Our response focuses in turn on:

- The FTRs and MTRs that UK operators can charge to EEA operators, including the interplay between Ofcom and the European Commission's Consultations;
- The MTRs that UK MNOs can charge to non-EEA operators; and
- Some practical points about Ofcom's proposed reciprocity condition.

Regarding the FTRs and MTRs that UK operators charge EEA operators, Ofcom should seek the Annex exemption proposed in the European Commission's Consultation. This would guarantee a low-low scenario, where TRs paid between UK and EEA operators are low, to the benefit of UK consumers. If Ofcom cannot secure an Annex exemption, it should depart from the current regulation (as it proposed before the European Commission's Consultation was published). In this scenario, we support Ofcom's proposed reciprocity condition, but consider Ofcom should go further and allow pricing freedom.

Regarding the FTRs and MTRs that UK operators charge non-EEA operators, we support Ofcom's proposed departure from the existing regulation. As with EEA calls (if Ofcom does not secure the Annex exemption), we support Ofcom's proposed reciprocity condition but believe Ofcom should go further and allowing pricing freedom.

Lastly, we explain that it is unlikely to be possible to perfectly implement Ofcom's proposed reciprocity condition. We ask Ofcom in its Statement to give guidance on the issues we identify and confirm that our proposals to make the condition workable will be acceptable.

[1] https://www.ofcom.org.uk/__data/assets/pdf_file/0012/201315/consultation-2021-26-wholesale-voice-markets-review.pdf
[2] https://op.europa.eu/en/publication-detail/-/publication/050369b1-e6b5-11ea-ad25-01aa75ed71a1/language-en

Contents.

1. Regulation of TRs for calls from EEA operators should depend on the European Commission’s decision on Union-wide TRs.

1. **If current EU MTR rules no longer apply after the Transition Period, there is a risk that EEA operators will increase TRs.**

1.1. We have highlighted to Ofcom the risk that from 1 January 2021, EEA operators could increase the TRs they charge to UK operators, depending on the outcome of negotiations between the UK Government and the EU. This outcome is most likely to occur if Ofcom continues requiring UK MNOs to charge the same MTR to UK and EEA operators. [✂].

1.2. We are therefore supportive of Ofcom’s efforts to mitigate this risk, by proposing to depart from the status quo and allow reciprocity, whereby UK MNOs can charge the higher of the UK domestic MTR and the TR charged by each EEA operator. This would reduce the risk to Three UK in that scenario. However, the proposals from the European Commission may mean that Ofcom needs to significantly change its regulation of FTRs and MTRs, as explained below.

2. **Interplay between Ofcom and the European Commission’s Consultations.**

2.1. Shortly after Ofcom published its Consultation, the European Commission published proposals for a single, Union-wide maximum MTR and FTR.[3] We consider that these proposals should have a significant bearing on how Ofcom regulates the FTRs and MTRs that UK operators can charge EEA operators. The European Commission’s proposals would apply to calls originating and terminating in the Union, but crucially the European Commission proposes two routes for “third” operators or countries to benefit from these maximum Union-wide TRs.

2.2. The European Commission’s Consultation explains that Articles 4 and 5 (the Union-wide MTRs and FTRs, respectively) could also apply to calls originating in “third countries” and terminating in the Union where one of two conditions is met (see table below).

[3] https://op.europa.eu/en/publication-detail/-/publication/050369b1-e6b5-11ea-ad25-01aa75ed71a1/language-en

	EC's Consultation	Our interpretation and implications
Article 1, 4(a)	"where a provider of voice termination services in a third country applies to calls originating in the Union, mobile or fixed voice termination rates equal or lower than the maximum termination rates set out in Articles 4 or 5 respectively, for each year and each Member State, on the basis of rates applied or proposed by providers of voice termination services in third countries to providers of voice termination services in the Union;	Our interpretation UK MNOs could choose to charge, to every EEA operator in every year, MTRs not higher than the Union-wide maximum MTR proposed by the EC. By doing so, UK MNOs would benefit from the Union-wide MTRs and FTRs. Implications The Union-wide MTR is 0.7c/min in 2021, reducing via a glide path to 0.2c/min in 2024. Were a UK MNO to charge no more than this level, it would remove the risk of EEA operators charging it higher TRs from 1 January 2021. However, the UK MNO would in future make an incremental loss on terminating calls because the glide path falls below Ofcom's estimated LRIC of terminating a call on a mobile network in the UK.
Article 1, 4(b)	"with regard to all calls originated in a third country and terminated in the Union, when (1) the Commission determines that, on the basis of information provided by that third country, voice termination rates for calls originating in the Union and terminating in that third country are regulated in accordance with principles equivalent to those set out in Article 75 of Directive (EU) 2018/1972 and Annex III thereto; and (2) that third country is listed in the Annex to this Regulation" Annex III[4] explains that: (a) rates shall be based on the recovery of costs incurred by an efficient operator; the evaluation of efficient costs shall be based on current cost values; the cost methodology to calculate efficient costs shall be based on a **bottom-up modelling approach using long-run incremental traffic-related costs** of providing the wholesale voice termination service to third parties"	Our interpretation Ofcom would need to demonstrate to the Commission that the MTRs and FTRs that UK operators charged to EEA operators were regulated based on a bottom-up LRIC cost estimate (as explained in Annex III). That is to say, Ofcom would have to regulate FTRs and MTRs at LRIC. This is a departure from Ofcom's proposals to allow reciprocity, where UK operators could charge the higher of 1) LRIC and 2) the TR it is charged by each EEA operator. We also understand that Ofcom would have to regulate FTRs for non-geographic numbers at LRIC (Ofcom only proposes to regulate geographic numbers at LRIC). Implications This would guarantee a low-low scenario, and allow UK MNOs to charge MTRs at LRIC in every year (rather than possibly charging below LRIC).

[4] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L1972&from=pl

2.3. We have responded to the EC's Consultation via our Group company, supporting the inclusion of both options. However, we believe that UK consumers will be best served if Ofcom can secure the Annex exemption, which would guarantee the low-low scenario where TRs paid and received by UK operators are low, i.e. regulated at LRIC. Otherwise UK MNOs would have two choices:

- Charge no more than the Union-wide MTRs to each EEA operator in every year. This would protect the MNO from the EEA operators charging higher TRs but would result in the MNO having to charge below LRIC once the Union-wide MTR falls below Ofcom's estimated LRIC of terminating a call on a mobile network; or
- Charge an MTR in excess of the Union-wide MTRs, at least to some EEA operators in some years, e.g. charging LRIC in every year. This would avoid the MNO having to charge below LRIC for terminating calls but would mean EEA operators would have pricing freedom in the TRs they charge the UK MNO.

For Ofcom to seek the Annex exemption, we understand that Ofcom would have to make two changes to its proposed regulation

2.4. We understand that Ofcom would need to make two changes to its proposals to secure the Annex exemption:

- Require UK operators to charge the same FTRs and MTRs on calls originated in the EEA as they charge for UK-originated calls, i.e. not allow reciprocity as proposed. This would demonstrate to the European Commission that voice termination rates for calls originating in the Union and terminating in the UK are regulated in accordance with principles in Article 75 of Directive (EU) 2018/1972 and Annex III; and
- Ofcom may also need to regulate FTRs for non-geographic numbers, e.g. 03 numbers, such that FTRs for all UK fixed numbers were regulated at LRIC.

2.5. Ofcom has proposed a reciprocal condition for FTRs (geographic numbers) and MTRs. Under this condition, UK operators could charge at least Ofcom's estimate of LRIC, but could charge in excess of this, to any individual international operators that charged the UK operator a higher TR. Our understanding is that, were Ofcom to maintain its proposed reciprocity condition, Ofcom would not be able to secure the Annex exemption. This is because the FTRs and MTRs would not be regulated in accordance with principles equivalent to those set out in Article 75 of Directive (EU) 2018/1972 and Annex III thereto, namely clause (a) of Annex III:

> "rates shall be based on the recovery of costs incurred by an efficient operator; the evaluation of efficient costs shall be based on current cost values; the cost methodology to calculate efficient costs shall be based on a **bottom-up modelling approach using long-run incremental traffic-related costs** of providing the wholesale voice termination service to third parties"

2.6. If Ofcom allowed reciprocity, but every UK fixed (geographic and non-geographic) and mobile operator charged TRs at LRIC to EEA operators, this may still not be sufficient to get the Annex exemption. Therefore, we consider that Ofcom must depart from its reciprocity proposals if it wishes to seek the Annex exemption.

2.7. The European Commission's Consultation defines "fixed voice termination service" as the "wholesale service required to terminate calls to geographic and non-geographic numbers other than mobile numbers that are publicly assigned numbering resources".[5] It is our understanding, based on internal discussions and discussions with our Group company, that as the European Commission's Consultation is currently drafted, were Ofcom not to regulate the FTRs for all fixed numbers at LRIC, Ofcom would not be able to secure the Annex exemption.

2.8. If our understanding is correct and Ofcom could not or would not regulate FTRs for all non-geographic numbers at LRIC, Ofcom should lobby the European Commission to allow the Annex exemption to apply to all UK MNOs, in the event that Ofcom required UK MNOs to charge MTRs at LRIC to EEA operators. It would be harmful to UK consumers if UK MNOs could not benefit from the Annex exemption, were Ofcom not to regulate FTRs for non-geographic numbers at LRIC.

<u>Ofcom's regulation of MTRs and FTRs charged to EEA operators must depend on the decisions made by the European Commission</u>

2.9. We understand that the European Commission will publish its decision by the end of 2020, i.e. before Ofcom expects to publish its Statement. If the European Commission maintains its proposed Annex exemption, Ofcom should seek to get the UK added to the Annex, as it ensures a low-low scenario which is optimal for UK consumers. Ofcom should therefore explore the two potential changes needed to its regulation we have highlighted above, namely requiring FTRs and MTRs charged to EEA operators to be at most LRIC (rather than the proposed reciprocity condition) and regulating FTRs for non-geographic numbers.

2.10. However, if the European Commission does not maintain its proposed Annex exemption, Ofcom should depart from the status quo (as proposed). Ofcom's proposed reciprocity condition offers some protection against the risk of higher MTRs on UK-originated calls to EEA operators, which is positive for UK consumers (and better than the status quo). However, we believe that in this event, Ofcom should allow pricing freedom for the MTRs charged to EEA operators.

2.11. Ofcom may be concerned that if UK MNOs were allowed pricing freedom, a "race-to-the-top" would arise, if UK MNOs were net receivers of calls from EEA operators. However, this narrow examination ignores the retail market impact of an MNO being able to offer competitive international calling and roaming propositions. The profitability associated with increased demand from existing and/or new retail customers may outweigh the incentive for a UK MNO to increase MTRs on the narrow wholesale revenue considerations.

2.12. Further, even if UK MNOs did increase MTRs due to having pricing freedom, this would increase the value of customers that receive calls from EEA operators. As a consequence, competition among MNOs for these customers would intensify, resulting in lower retail prices, i.e. the waterbed effect.

[5] Article 2, para 1(b), European Commission's Consultation

2. For TRs charged to non-EEA operators, Ofcom should allow pricing freedom.

2.13. Currently, most operators in non-EEA countries can charge high TRs for calls from UK MNOs, safe in the knowledge that UK MNOs can only charge approximately 0.5p/min in response. The result is that Three UK pays on average [✂]p/min on UK-originated calls to non-EEA countries. [✂].

2.14. We therefore welcome Ofcom's proposed departure from the status quo. [✂].

2.15. As with EEA calls (if Ofcom cannot achieve the Annex exemption), we believe Ofcom should go further and allow pricing freedom rather than reciprocity. Ofcom's analysis ignores the retail market impact of being able to offer competitive international calling and roaming propositions, and if UK MNOs increased the MTRs charged to non-EEA operators then competition for customers that receive calls from non-EEA operators would increase, leading to lower retail prices (the waterbed effect).

3. If Ofcom allows reciprocity, it must allow some flexibility to make the regulation workable.

6. It is unlikely to be possible to perfectly implement Ofcom's proposed reciprocity condition.

2.16. If Ofcom maintains its proposed reciprocity condition (for non-EEA calls and potentially also EEA calls), we ask Ofcom in its Statement to give guidance on the following issues and confirm that our proposals to make the condition workable will be acceptable. We note that these issues would not occur if Ofcom allowed pricing freedom:

- **Missing/incomplete CLI:** Some inbound calls from international operators will have missing or incomplete CLI. This is more likely if UK MNOs can charge different MTRs to different international operators, as international operators will "spoof" their identify to try and pay lower MTRs for calls to UK MNOs. Under Ofcom's proposed reciprocity condition (as drafted), UK MNOs would have to charge the UK domestic MTR (proposed base case of 0.4p/min) to avoid overcharging. We believe Ofcom should explicitly state that in this scenario, UK MNOs can apply a default rate (significantly higher than the UK domestic MTR) or have complete pricing freedom, to avoid an increase in masking CLI and encourage international operators to correctly identify the origin of calls;

- **Porting:** Based on internal discussions to date, we understand that where customers from international operators port their mobile number, we would not be able to capture this. Instead, we would see the "A-number" of the original network, and charge an MTR accordingly. We propose that Ofcom explicitly allows this, i.e. charging MTRs based on the A-number. This could mean that UK MNOs charge a higher TR to certain international operators than they pay in response, but not intentionally. This is what our sister OpCo (3 Austria) does, which allows the reciprocal condition to be workable;

- **Time to react to changing TRs from international operators:** If an international operator reduces the TR it charges Three UK, we will need to become aware of this so that we can reduce the MTR we charge that operator. This will not be possible immediately, so we ask that Ofcom allows sufficient time for this, e.g. requiring us to ensure reciprocity on a quarterly basis. [✂].

- **Imperfect information on the TRs we are charged:** To date, it has not been possible for Three UK to perfectly identify the TRs we are charged by each international operator (as we explained in response to Ofcom's formal information request in the context of this market review). This is because there could be several carriers involved in connecting an international call [✂] that may add a mark-up on top of the underlying TR. We propose that Ofcom tolerates this imperfection or provides guidance on how UK operators can be compliant with the proposed reciprocity condition in this situation.