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NON – CONFIDENTIAL VERSION

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Dear Dermot

Hutchison 3G UK Limited ("H3G") response to "Amendment to charge control on Mobile Network Operators: proposals for consultation", (the "Consultation") published 27 March 2007

H3G welcomes that Ofcom is finally recognising the need to address the fact that the current mobile number portability ("MNP") arrangements in the UK distort the payments of Mobile Termination Rates ("MTR"s) and have an impact on the accuracy and effectiveness of the appropriate remedies to be applied to MTRs. The current price cap[1] significantly distorts competition between the mobile network operators ("MNOs"), the effect of which is materially worsened by the combination of the current MNP arrangements with the fact that the price cap applies only to calls for which H3G "sets the charge".[2] As such, the proposals set out in the Consultation are welcome and a move in the right direction. However, Ofcom is dealing with this issue far too late in the process and the method applied is not sufficient to address the problems raised by the current system.

As Ofcom is aware, H3G has a range of wider concerns with the conclusions in the SMP/Price Control Decision which have led to it having to appeal that decision.[3] This response solely concentrates on the specific point raised by the Consultation, and is without prejudice to the wider concerns which H3G has on the SMP designation and price control remedies as raised in H3G's appeal of the SMP/Price Control Decision.

1 As imposed by SMP conditions MA3 and MA4 in "Mobile call termination: statement", published 27 March 2007 (the "SMP/Price Control Decision"), which is the conclusion on the most recent market review of mobile voice call termination (the "Market Review").

2 As set out in the definitions of "Mobile-to-Mobile Interconnection Charge" and "Fixed-to-Mobile Interconnection Charge" in the current SMP Conditions set out in the SMP/Price Control Decision.

3 See notice of appeal filed on 23 May 2007 in relation to Case 1083/3/3/07 *Hutchison 3G UK Limited v Office of Communications*.

This response provides answers to the specific consultation questions raised in the Consultation in the Annex attached below. However, this response first sets out why H3G considers that:

- Ofcom has shown a worrying lack of urgency in dealing with this point, despite it being repeatedly raised by H3G;
- this delay will have real costs in terms of its detrimental effect on competition and should not be compounded by further delay by Ofcom;
- Ofcom's proposed solution is inadequate to remove all potential distortions arising from the current MNP arrangements; and
- an appropriate approach requires that each operator is able to charge its own rate for all terminating traffic. This would be the case under a direct routing solution.

H3G also notes O2's appeal of the SMP/Price Control Decision[4] which potentially complicates Ofcom's proposed approach, and makes it all the more urgent that Ofcom impose a direct routing solution on the industry. H3G also urges Ofcom not to further delay action due to O2's appeal.

1. The effect of ported number charging on call termination has been addressed too late

H3G has significant concerns about the lack of urgency with which Ofcom has dealt with this issue and the delay which Ofcom's approach implies in ensuring that any price cap on mobile call termination rates ("MTRs") does not distort wider competition in the mobile sector.

H3G has consistently raised the issue that the current indirect routing arrangements for MNP create a distortion in the MTRs which are charged and noted that Ofcom's approach does not deal with this distortion. For example, H3G raised this issue in its response to the first consultation of the Market Review process:[5]

> *"<u>The consultation does not consider the distortion to the average termination rate caused by… MNP.</u> The current indirect routing solution employed between mobile networks means that the recipient network receives the termination rate set by the donor network rather than its own regulated rate."*[6] (emphasis added)

Similarly, in response to Ofcom's second consultation[7] on the Market Review, H3G stated:

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4 Case 1084/3/3/07 - *O2(UK) Limited v Office of Communications*.

5 "Wholesale mobile voice call termination markets: preliminary consultation on future regulation", published on 7 June 2005 (the "Preliminary Consultation")

6 Section 5.2 of H3G's response dated 30 August 2005 to the Preliminary Consultation.

7 "Mobile Call Termination Market Review", published 30 March 2006 (the "March 2006 Market Review Consultation").

"This is a matter around the appropriateness of the existing MNP arrangements and cannot be used as a justification to reach inappropriate conclusion on call termination charge controls.
Ofcom should be addressing the root cause of the problem, not introducing further work around solutions, which will become increasingly unsustainable and inefficient."[8] (emphasis added)

Likewise, in response to Ofcom's draft conclusions on the Market Review,[9] H3G discussed the impact of MNP on the appropriate level of call termination price caps in detail. In particular, it stated:

"The proposals in the Market Review Consultation effectively conclude that the impact of MNP is not material on this assessment. As a result, Ofcom proposes that the price cap only applies to that traffic for which the relevant operator sets the charge (i.e. not minutes to ported numbers under the current MNP arrangements). This assumption of immateriality is not in fact true in the case of H3G. The current MNP arrangements have a very significant effect on the effective charge H3G achieves (reducing the effective charge it receives on current volumes by the order of [•])."[10] (emphasis added)

Having raised the issue of the appropriate treatment of calls to ported numbers under any price cap throughout the lengthy Market Review process and, indeed, consistently with Ofcom and Oftel for years before the Market Review started,[11] H3G is baffled as to why Ofcom has been unable to implement a remedy from 1 April 2007 which takes this factor into account.[12] Yet Ofcom has only consulted on this issue, which H3G has been raising for years, after the Market Review had concluded.

This error is compounded by the manner in which Ofcom is now considering the issue. H3G sees no reason for the further delay that Ofcom has injected into the process. Ofcom has unnecessarily allowed for a ten week consultation on amending the price control formulae

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8 See table 1 in section 3.3 of H3G's response dated 26 May 2006 to the March 2006 Market Review Consultation. H3G also addressed this issue in section 3.2.3 of that response which urged Ofcom to provide further clarity on how it proposed to deal with this issue and not to perpetuate the inefficiencies of the current MNP solution.

9 "Mobile call termination: proposals for consultation" published 13 September 2006 (the "September 2006 Market Review Consultation")

10 See especially section 5.3 of H3G's response dated 22 November 2006 to the September Market Review Consultation, from which this quotation is taken.

11 See, for example, the summary of H3G's evidence to the Competition Commission in its 2002 report on calls to mobiles paras 15.94 and 15.95. In relation to earlier market reviews, H3G raised the effects of number portability on its mobile voice call termination charges in its response to Oftel's "Explanatory Statement and Notification on Wholesale Mobile Voice Call Termination" (published 19 December 2003) at para 2.30 and in its response to "Review of wholesale mobile call termination markets" (published 15 May 2003) at paras 4.18-19.

12 Given that H3G has been raising this point so consistently, it is not clear why Ofcom did not consult on this point before publishing its final decision on the Market Review. There was ample time for an additional consultation between receiving the response to the draft conclusions on 22 November 2006 and the publication of final conclusions on 27 March 2007.

published at the same time as the SMP/Price Control Decision. Given that Ofcom erroneously waited to address the issue until after the Market Review was concluded and decision taken, such a protracted consultation period was inappropriate when there is a clear need to make an important technical change to the price control formulae.[13] Ofcom could and should have been able to introduce an appropriate change to the price control formulae in its final decision on the Market Review before the price control came into effect. It has failed to address the matter with urgency thereafter. It should not compound its errors by any further delay.

2. The impact of delay

As the Consultation recognises, ignoring the impact of the MNP arrangements on price controls on MTRs has a "disadvantage" in that:

> *"MNOs will receive an average effective termination rate (i.e. taking into account both ported-in minutes and directly routed minutes) that differs from (i.e. could be higher or lower than) the ceiling for wholesale termination charges set by Ofcom"* (paragraph 1.6 of the Consultation).

Further, the Consultation also recognises that these arrangements lead to further distortions to:

> *"(i) the incentive to encourage subscriber to switch from one network to another; and (ii) the incentive to encourage subscribers that do switch to port/change their number"* (paragraph 1.7 of the Consultation).

These are significant distortions to the competitive process in the mobile sector. They create an on-going impediment to H3G acquiring customers. In direct financial terms, H3G estimates that the cost of the current price control compared to what the Consultation suggests is the correct approach, for just the six months of the first year of the price control period, will be around ***[●]***. What is more, H3G's competitors, such as O2, will obtain a direct (and unwarranted) financial benefit from the delay in correcting the price control formulae, by having a slightly higher effective average voice call termination rate.

There will also be other indirect effects ***[●]***. As identified in the Consultation, the current arrangements distort the other MNOs' incentives to compete at the retail level. Delay in implementing this adjustment to the price control formulae will therefore perpetuate the barrier to customer switching, thus reducing the effectiveness of competition for new subscribers.

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13 This can be compared to Ofcom's approach in imposing the end-to-end connectivity condition on BT, which Ofcom considered an urgent requirement and which Ofcom believed had a significant impact on the determination of SMP on H3G. This condition was subject to only a four week consultation around August 2006 such that the final condition could be imposed at the same time as Ofcom published its draft conclusions on the Market Review on 13 September 2006.

Given these further detriments to competition of continuing to delay, and the fact that H3G has been raising the need to address this point for many years, Ofcom must conclude this Consultation and amend the price control formulae as a matter of urgency, especially if Ofcom continues in its approach of only introducing the effect of this change from the date the amendment to the price control comes into effect.

3. Ofcom's proposals do not properly address the impact of ported number charging

Notwithstanding the above, Ofcom's preferred solution to addressing the distortion to the price control remedy created by the charging arrangements for ported-in numbers is inadequate and sub-optimal. The distortions discussed in the Consultation are not removed by the proposed amendment to the price control formulae, only reduced. Nor does Ofcom's Option 4 fully deal with the issues H3G has consistently raised in its consultation responses. Moreover, the approach proposed is not future proof.

In particular:

- Ofcom's proposed approach is not robust to other operators (presumably without regulated MTRs) joining the MNP system before the current MNP2 system is replaced with an All Call Query / Central Database solution (as Ofcom has proposed and the decision on which is currently being awaited);
- the approach of building in to the price control formula the Target Average Charges[14] ("TACs") of the other operators will not necessarily fully correct for the distortion created: H3G believes that this approach is likely to underestimate the impact of indirect routing (therefore not fully correcting the distortion);[15] and
- as is accepted in the Consultation, there is an issue which needs to be addressed and it is therefore unclear why this does not apply to the initial period of the price control period before the proposed amendment comes into effect.

4. An appropriate approach to ported number charging in relation to call termination remedies

The appropriate approach to this issue is to ensure that direct routing is mandated as soon as possible. Ofcom has that opportunity in the imminent decision regarding the review of General Condition 18. If Ofcom continues to believe that Option 4 in the Consultation is appropriate, at least in the interim, it should be amended for the reasons set out below.

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14 As defined in the proposed SMP Conditions MA3.2.1 and 4.2.1 and explained in paragraph 5.15 of the Consultation.

15 The difference arises because each MNO will still over-recover from H3G the MTR payments to the minutes that they port in from H3G. *[●]* This is discussed further in Section 4 below.

The first year TAC for each operator should be adjusted to take account of the fact that this distortion is not being addressed (and the price cap formulae amended) at the same time as the price control came into effect. That is, the TAC should be changed for each operator by an appropriate amount to reflect the fact that the Average Interconnection Charge ("AIC") is calculated for the first portion of the price control year ignoring the impact of the charging arrangement for ported-in numbers.[16] Alternatively, Ofcom could determine that the revised price control formula should apply for the whole of the year (rather than calculating the first year AIC as a weighted average of the current approach and the proposed approach).

However, Ofcom's preferred Option 4 is inappropriate in another way. The calculation of the AIC under the new formula should aim to take account of average charges which each operator actually achieves for ported-in numbers. This would be equivalent to the position which arises under the direct routing solution which H3G has submitted to Ofcom is the appropriate way forward for MNP.

Ofcom's proposed adjustment to the price control formula effectively allows a change in the average interconnection charge for directly routed minutes to take account of the "wrong" charge being levied on ported-in minutes. In H3G's case this means that the average interconnection charge for directly routed minutes can increase in order to compensate for the lower rate received (the combined 2G/3G rate) for ported-in minutes. This adjustment is based on the overall TACs applicable to *all minutes* under the proposed formula. In practice, this means that H3G will not be able fully to offset the effect of not receiving the correct rate for ported-in minutes. This is because, for ported-in minutes, it will receive the actual average interconnect charge on *direct* minutes of the other operators whereas it will only be able to take account of the TAC (which may be higher) in setting its own rate on direct minutes. Similarly, the combined 2G/3G operators will receive H3G's average interconnect charge on their ported-in minutes but will only need to take account of H3G's lower TAC in setting their own average interconnect charge on direct minutes. Overall, this will mean that the combined 2G/3G operators will still be able to over-recover under Ofcom's own calculations and H3G will still be under-recovering against the price control.[17]

H3G therefore believes that the relevant arrangements should be changed to remove this remaining distortion. This could be achieved by each operator charging its own termination rate for calls to ported-in numbers as well as calls to directly routed numbers: this will require some amendment to billing but H3G believes it is achievable *[●]*. The desirability of this approach would appear to be reinforced by the O2 appeal of the SMP/Price Control Decision.

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16 *[●]*.

17 This is on the assumption that Ofcom's assessment of costs is appropriate. In its appeal submitted on 23 May 2007 H3G has set out why it believes that Ofcom's 27 March 2007 decision actually underestimates the relevant costs for H3G and overestimates the relevant costs for the combined 2G/3G operators. The effect discussed here will further exacerbate this disparity.

If Ofcom continues to believe that an amendment to the price control formulae is appropriate, adjusting the amount received for direct minutes to take account of the distortion on pricing for ported-in minutes, then that adjustment should take account of the full effect.[18]

5. Conclusion

Ofcom needs to be careful not to attempt to correct a regulatory distortion by creating another regulatory distortion. Although the amendments proposed in the Consultation are an improvement on the current situation, the optimal approach remains requiring operators to charge their own call termination rate for calls to ported-in numbers. H3G does not understand why Ofcom has not considered this as an option in the Consultation. *[●]* at least as between H3G and the other operators, Ofcom could address the issue in this Consultation process.

In the absence of such an approach, Ofcom should amend the price control formula in such a way as to mimic this optimal outcome as closely as is feasible and, preferably, in a way which is robust to other operators joining the MNP system. Ofcom also needs to address the fact that this amendment to the price control formulae is being implemented late, after the start of the price control period.

Yours sincerely,

Tim Lord
Regulatory Director

18 H3G would be happy to discuss further with Ofcom how such an approach could work, once there is clarity on Ofcom's decision on the review of General Condition 18.

Annex: answers to specific consultation questions

Question 1: What are respondent's views on the appropriateness of Option 1 as a solution to the distortions created by the existing MNP mechanism on [Mobile Call Terminatio] ("MCT")?

This is Ofcom's "do nothing" option, which would have the effect of leaving the price control formulae as they are determined in the SMP/Price Control Decision. It should be clear from H3G's previous responses to the Market Review and this response that H3G strongly disagrees that this option would be appropriate. Indeed, this is one of H3G's grounds of appeal in relation to the price control (see section 9 of the Appendix to the Notice of Appeal on price control matters).

H3G firmly believes that the price control formulae must take into account the fact that under current MNP arrangements MNOs do not receive their own termination rate for call calls to ported-in numbers. As such, there is a distortion to incentives and competition which needs to be addressed.

Question 2: What are respondent's views on the appropriateness of Option 2 as a solution to the distortions created by the existing MNP mechanism on MCT?

This solution, of a system of inter-operator *ex post* financial settlement payments with respect to mobile termination revenues to take account of the fact that each individual MNO does not receive its own termination rate for calls to ported-in numbers, is likely to be an impractical solution. First, in the way envisaged in the Consultation, this approach appears to be limited to transferring revenue raised from call termination between operators to correct for the distortion.[19] As Ofcom points out, there is nothing to make certain therefore that over and under payments resulting from the current arrangements for charging for ported-in numbers will be properly corrected. Second, the *ex post* nature of this proposed solution also means that the incumbent MNOs would continue to gain from the solution for the period before the financial settlement payments were made. Finally, the practical billing arrangements for implementing such a solution are likely to be disproportionate.

However, H3G notes that this approach (if the unnecessary constraint that the amount of under-payments which are made up to H3G at the end of the period are not limited to the amount of over-payments received by the incumbent operators) would ultimately have a similar financial impact to its preferred solution of each operator charging its own rate for all traffic (as under a direct routing solution).

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[19] This is clear from paragraph 4.34 of the Consultation where Ofcom states *"Unless this exact equalisation always occurs [of the over and under payments of MTRs], it will not be possible to fully correct for the impact of ported-in numbers on MNOs' termination revenue through inter-operator settlements"*. (Emphasis added).

Question 3: What are respondent's views on the appropriateness of Option 3 as a solution to the distortions created by the existing MNP mechanism on MCT?

Ofcom's third option is to increase or decrease the relevant TACs by amounts which would take into account the expected impact of the current MNP arrangements and the wrong charges being made for ported-in numbers. H3G agrees that this approach would be inappropriate.

The reasons for this are that this would place unnecessary reliance on forecasts of ported-in numbers in order to calculate the correct TAC for each operator (which in itself could distort incentives for operators). This would likely increase regulatory risk, ***[●]***. Such an approach would also require forecasts to be made about when the results of the review of General Condition 18 were implemented and could provide an additional unwarranted complication to that process.

Question 4: What are respondent's views on the appropriateness of Option 4 as a solution to the distortions created by the existing MNP mechanism on MCT?

See section 3 of this response for the reasons why Ofcom's preferred solution to the issue raised in the Consultation is inadequate and needs further adjustments.

Question 5: Do respondents agree with Ofcom's conclusion?

H3G agrees with Ofcom that an amendment to the price control formulae is required to remove some of the distortions created by the interaction of the current MNP arrangements with the price control remedies. H3G continues to believe that, even with such an amendment, there is an urgent need to reform the current MNP solution and move to a direct routing solution which is recipient led (and not controlled by the donor network: that is. the network from which the relevant number is being ported). H3G is awaiting Ofcom's impending statement on this issue following the consultation reviewing General Condition 18 published in November 2006.

For the reasons set out in this response, the amendment to the price control formulae set out in the Consultation is not sufficient and should in some form take into account the actual revenues which MNOs receive for call termination to ported-in numbers as well as the fact that it has not been implemented from the start of the current price control period. Section 4 of this response suggests how this could be achieved.

Question 6: What do respondents think about Ofcom's proposed amendment to the compliance formula?

H3G welcomes the additional clarity on the interpretation of the price control formulae provided by the algebraic representation provided in the Consultation.

As set out in sections 3 and 4 above of this response, H3G believes that the amendment to the price control formulae should be adjusted to be relevant to the whole of the first relevant year of the price control (not just from the date at which the amendment comes into effect). Notwithstanding this, under the proposal set out in the Consultation it is not clear how the weighted average of the two AICs across the two periods (the one before the amendment comes into effect and the one after) will be calculated. In particular, this "overall AIC" (as discussed in paragraph 5.18 of the Consultation) is to be:

> *"a weighted average of the two calculations"*

In conditions MA3.2.1(a) and MA4.2.1(a) this weighted average is to be calculated

> *"according to the proportion of total terminated minutes in the corresponding part of the Base Year"*

H3G requests that Ofcom clarify whether the "total terminated minutes" referred to in these conditions includes ported-in minutes.

Section 3 of this response sets out the further reasons why the proposed amendment does not sufficiently address the distortions created by the interaction of current MNP arrangements and the current price control formulae and section 4 sets out the consequent amendments which H3G believes would be appropriate.

H3G also notes that Ofcom has defined ported in traffic as that traffic for which operators do not set the charge. H3G believes that this definition is ambiguous and may, in fact, include traffic types (including for example internationally roamed traffic) which Ofcom does not intend to be included. H3G proposes that the definition of ported in traffic is all traffic which is routed using a Mobile Number Portability Code, where the Dominant Provider does not set the termination charge.[20]

The proposed amended price control conditions also use the terms "Direct Minutes" and "Ported-in Minutes". H3G proposes that the latter are instead termed "Indirect Minutes", which will be clearer when the ported-in minutes part of the equation falls away and there is no charging differential between ported-in and direct minutes. As Ofcom is aware, H3G has proposed that the direct routing solution, which would achieve this, should be implemented by the end of this year.

[20] As defined in the National Telephone Numbering Plan, published by Ofcom at http://www.ofcom.org.uk/telecoms/ioi/numbers/numplan0507.pdf