



## **Response to the Amendment to charge control on Mobile Network Operators consultation**

on behalf of Orange PCS Ltd

5 June 2007



## Introduction

Orange supports the basic objective of the proposals which Ofcom has outlined in the consultation.

In this response, we do not intend to address the fundamental questions concerning Ofcom's designation of Orange as having Significant Market Power (SMP) and the level of charge control and other conditions which have been imposed on Orange (and the other mobile network operators) as a result. Ofcom is aware of Orange's views on those issues and we reserve our position in that regard.

Accepting that Ofcom has imposed a charge control on call termination rates at a certain level, as a matter of principle it must be right that MNOs receive that regulated rate for all traffic terminated on their networks, rather than only directly routed traffic. There is no logical reason why the termination rate which an operator receives should be based on the network costs/termination rate of another operator.

Orange also does not intend to address in this response, the question of whether or when direct routing of ported traffic should be introduced, which would resolve the problem being addressed by this consultation. Ofcom will be aware from Orange's response to its earlier consultation '*Review of General Condition 18 – Number Portability*', that in principle we support the introduction of direct routing subject to appropriate timescales, full industry participation and equitable distribution of costs.

However, we are concerned that Ofcom has been unable to publish the outcome of that consultation prior to the deadline for responding to this consultation, particularly as we understood that the original timescales for doing so were during April. The two issues are, of course, inextricably linked and Ofcom's conclusions on direct routing may well have had a bearing on responses to this consultation. It is a matter of some regret that we are having to respond to this consultation, without knowledge of Ofcom's policy on direct routing.

However, Orange believes that some operators may attempt to use this consultation as a means of advancing their views on direct routing and putting pressure on Ofcom in relation to the form of direct routing to be implemented (fixed-mobile or mobile only) and over what time period. We believe Ofcom must resist that pressure. The major long term significance of any move to fixed-mobile direct routing means that decisions on what is the best and most equitable approach must be made in the interests of all consumers and the entire industry. Although Orange supports direct routing in principle, it must be done correctly. It is too important in the longer term to be affected by the short term financial interests of individual operators.



**1. *What are respondents' views on the appropriateness of Option 1 as a solution to the distortions created by the existing MNP mechanism on MCT***

Orange welcomes the inclusion of a 'do nothing' option in order to demonstrate that Ofcom has considered all possibilities for what form of intervention which may or may not be warranted. However, in this case we believe that intervention is justified and necessary to correct a distortion which has been allowed to continue for too long.

There is no logical reason why the termination rate which the recipient operator receives should be determined by the network costs/termination rate of the donor operator. The reason why this situation has been allowed to continue appears only to be a matter of pragmatism, or even inertia.

Until now Oftel/Ofcom have effectively taken a 'de-minimis' approach to the issue by concluding that the level of ported numbers/traffic is not sufficient to warrant action being taken. Although the level of ported traffic has previously been lower, this approach has discriminated against Orange as an 1800MHz operator with higher network costs and therefore a higher regulated termination charge. As a result, ever since MNP was introduced Orange has been receiving a lower termination rate from 900MHz/1800MHz operators than that to which it was entitled and those operators have been over-recovering at Orange's expense. That lost revenue will never be recovered. As Ofcom has accepted (at least during the earlier part of the charge control) that 1800MHz operators have higher costs than 900MHz/1800MHz operators, it is self-evident that they should be allowed to recover those costs on all calls terminated on their network.

The time for this anomaly to be resolved is long overdue and Orange only regrets that it has taken until now. In particular, we regret that these proposals have not been made prior to Ofcom's decision to remove the termination rate differential between 1800MHz and 900MHz/1800MHz which obviously significantly undermines the benefit to Orange and means that it will be time-limited. Conversely, H3G has been allowed to continue to maintain a higher termination rate and will therefore continue to benefit from these changes. Orange notes and regrets that this is not a benefit which Oftel/Ofcom afforded to it when it was in a similar position.

Orange notes with interest Ofcom's arguments about possible distortions in the retail market. Although there is logic to the argument that 900MHz/1800MHz operators may broadly be incentivised to try and acquire customers from the higher TAC operators, rather than each other, Orange does not believe that the argument that higher TAC operators are discouraged from offering MNP in individual cases accords with reality.

The market for acquiring customers is highly competitive and operators spend huge sums on acquisition costs to offer the best deals and the cheapest handsets. Orange agrees with Ofcom that number portability is a key factor in encouraging competition and promoting switching. It is therefore



not logical to suggest that in view of all of the effort and expense that goes towards acquisition, operators would not use number portability as an additional incentive to switch. In simple terms, operators will do everything possible to acquire customers from any of their competitors and number portability is a critical tool. An operator will not risk losing the customer altogether (to his existing or an alternative operator) by not promoting portability, purely because of the differential termination rate that it will receive on incoming calls.

Although there will be a degree of regulatory costs to the industry in implementing Ofcom's proposals, in practice it will not be significantly greater than that which is already required to comply with the call termination charge controls.

Orange is concerned that 900MHz/1800MHz operators and fixed operators will inevitably try to argue against Ofcom's proposals because of the obvious financial impact which they will have on them. We suspect they may question whether ported-in minutes should be included within the charge control or the compliance formula which Ofcom has employed or they may argue that the whole issue should be a matter of commercial agreement between the operators.

Ofcom will of course be aware that the respective positions of operators will be determined entirely by the financial impact of the proposals and so in many cases their interests will be diametrically opposed. In such circumstances commercial agreement is impossible and regulatory intervention is the only effective means of resolution.

Although the Communications Act 2003 allows for commercial disputes to be referred to and resolved by Ofcom, this is obviously not the preferred way in which to proceed. We would urge Ofcom to do everything possible to avoid multiple disputes being referred to it by all parties on this issue. As we have seen in other areas, this results in a very time-consuming, resource intensive and confused process which is in no-one's longer term interests. Orange has very real concerns that if Ofcom does not take firm action at this stage, that will be the inevitable result. We welcome Ofcom's initiative to address the issue now and urge it not to be diverted from that objective.

**2. *What are respondents' views on the appropriateness of Option 2 as a solution to the distortions created by the existing MNP mechanism on MCT?***

Orange has little to add to Ofcom's reasoning with which we entirely agree.

Although option 2 would go part way to resolving the problem (and on that basis is clearly preferable to option 1), the potential for imbalances would remain and therefore option 2 does not constitute a complete solution.

As Ofcom has identified, in order to be fully effective, any inter-operator financial settlement system (based purely on revenues generated by ported traffic) would require that the over recovery of lower



TAC operators exactly matched the under recovery of higher TAC operators and there is no particular reason to assume that will occur.

Orange is curious/concerned about Ofcom's description of this option as a "self-regulated" system. We assume that Ofcom had meant to propose that the day to day workings and operation of the system would be self-regulated, rather than its initial implementation, although this is not entirely clear.

For reasons outlined above, Orange would be very concerned if the decision to implement this (or any other) solution became a matter of self-regulation. We explained that the position of all operators would be determined by the financial impact of the proposals and therefore 900MHz/1800MHz would have no incentive to agree to any self-regulatory solution.

Orange would urge Ofcom to avoid such an approach although we assume this is not its intention because it has correctly identified the danger that those operators who would be adversely impacted would have an obvious incentive to resist and delay the implementation which is inevitably what would happen in practice. Ofcom has also identified that even without delays being caused intentionally it would take significant time and resource to agree and implement the inter-operator financial settlement system being proposed.

Therefore whilst option 2 does certainly have merit and would create a more equitable system, it also has difficulties and disadvantages which do not occur with other options.

### **3. *What are respondents' views on the appropriateness of Option 3 as a solution to the distortions created by the existing MNP mechanism on MCT?***

Once again, Orange has little to add to add to Ofcom's reasoning with which we agree.

In theory, if accurate forecasts could be provided, this would constitute a largely effective solution to the problem (retail incentives aside). However, in reality it would be impossible to provide forecasts with sufficient confidence that they would have anywhere near the degree of accuracy required for these purposes.

It is extremely difficult for operators to forecast the number of subscribers who will port from each of their competitors, because no operator can know the marketing or pricing plans of its competitors, so it cannot know if its own offerings will be sufficiently attractive to encourage their subscribers to switch. Indeed, in a competitive market, operators are likely to have to change and develop their plans in response to what their competitors do and so are unlikely even to be able accurately to forecast their own plans or their financial affordability in the medium to long term.



In addition, the mobile market can be expected to change and develop very significantly. This could be as a result of convergence of services/development of new services or consolidation of existing players or the emergence of multiple new entrants (as MVNOs, VoIP/Wifi or DECT guardband operators). Orange notes that there are already 7 new operators working towards offering MNP in 2007 and with further spectrum awards pending, more new entrants can be expected.

When all of this uncertainty caused by competitive dynamics is set against the need to provide forecasts 4 years in advance, it becomes a virtually impossible task. Very little in terms of subscriber numbers/ported minutes can accurately be predicted over that timescale.

Moreover, operators would have a very obvious incentive to mis-forecast their predicted number of ported minutes, if they knew that their TAC would be based upon that forecast. In particular, 900MHz/1800MHz would obviously be incentivised to forecast a very low number of ported in minutes from higher TAC operators in the knowledge that would lead to them being granted a higher TAC. It is difficult to see any way around this major obstacle, which would leave Ofcom itself having to make its own forecasts without influence from the operators, which would of course be impossible.

This is directly linked to the issue of continuing retail market distortions to which Ofcom refers and the arguments are the same as those previously discussed. In order to maximise their 'margin' the 900MHz/1800MHz operators would be incentivised to **forecast** a low number of ported minutes from higher TAC operators (as above), but actually to **achieve** a high number of ported minutes from higher TAC operators.

For all these reasons, although in theory option 3 provides an attractive solution, in reality it has major difficulties and perverse incentives in its implementation.

4. ***What are respondents' views on the appropriateness of Option 4 as a solution to the distortions created by the existing MNP mechanism on MCT?***
5. ***Do respondents agree with Ofcom's conclusion?***

Orange will respond to questions 4 and 5 jointly, as they both ask for comments on the appropriateness of implementing option 4.

Orange agrees that option 4 represents the best available solution. It means that the TACs do not need to be reviewed by Ofcom, but operators are able to adjust their day/evening/weekend rates to ensure that their Average Interconnect Charge (AIC) takes into account of the proportion of calls terminated on their networks which have been routed over the network of another operator which may have a TAC higher or lower than its own. On that basis Orange would expect that changes to its rates and its resulting AIC will effectively allow it to recover (most, but not all of) the revenue it



loses on minutes ported in from operators with a lower TAC, who only pass on their lower termination revenue.

Orange also agrees that that option 4 does not have any of the major drawbacks which Ofcom highlighted would cause difficulties or not fully resolve the problem, if option 2 or option 3 were implemented. In particular, it does not rely on accurate forecasts, nor should there be any major issues of shortfall of funds as this option does require that volumes of ported traffic between operators are equal.

However, Orange recognises that this is not a perfect solution, as discussed further below in relation to the compliance formula. Nevertheless, we believe that it represents a very significant improvement on the current situation and therefore must be implemented, even though it may be easy to identify some potential flaws. Orange believes firmly that the accuracy and effectiveness of what is delivered by option 4 (by way of overall AIC (of ported-in and directly routed minutes) reflecting overall TAC) should not be judged against the accuracy and effectiveness of a direct routing/terminating scenario. (We accept, of course, that direct routing/terminating would ensure that operators receive precisely the termination revenue to which they are entitled on ported-in minutes.) Rather it should be judged against the accuracy and effectiveness of the current 'donor passes all' system, upon which it is a vast improvement.

It may be easy for 900MHz/1800MHz operators and fixed operators to argue that option 4 does not represent a perfectly accurate or ideal solution and therefore it should not be implemented. However, Orange would argue that the extent to which it is inaccurate, is to the benefit of those operators (as discussed further below) and so does not constitute a reason not to proceed. If 900MHz/1800MHz operators and fixed operators are unable to propose any preferable or more equitable solution, they must accept that option 4 is the best available. They cannot expect to continue to profit unfairly and indefinitely at the expense of competitors.

## **6. *What do respondents think about Ofcom's proposed amendment to the compliance formula?***

As is mentioned above (and Ofcom itself appears to acknowledge) there are some difficulties with the proposed compliance formula.

The AIC is calculated according to prior year volumes of ported in minutes from each of the other operators. Although this is a similar principle to that which Ofcom describes as the "original calculation" for determining the AIC, the traffic volumes ported in from each of the other operators may be expected to vary more over a year than the proportion of day, evening and weekend traffic. More importantly, the total volume of ported traffic can be expected to increase year on year.



This means that if a higher TAC operator ported in a larger number of minutes from a lower TAC operator in year 2, than it did in year 1 (which is very likely) the higher TAC operator will still continue to suffer an adverse revenue impact. Likewise, if a lower TAC operator ported in a larger number of minutes from a higher TAC operator in year 2 than it did in year 1, it will continue to benefit. In both cases, this is because the AIC will be based on porting volumes which are a year out of date which will mean that higher TAC operators under-recover and lower TAC operators over-recover relative to their actual porting volumes in any given year. Unfortunately, this appears to be an unavoidable consequence of the preferable position of the lower TAC operators.

Ofcom correctly identifies that (in theory) in determining how the average termination charge for ported-in minutes should be calculated, the preferred solution would be to calculate the average time of day charge for each operator weighted by their relative prior year volumes at each time of day. (It should be noted that this does not overcome the difficulties of using prior year volumes highlighted above.) However, Orange agrees that this option has significant implementation difficulties. Therefore, whilst the use of the TAC as a proxy of the average charge is something of a blunt and less precise instrument, Orange accepts that it provides a reasonable substitute for real average figures. More particularly, Orange is not aware of any preferable alternative.

The problems of certainty and predictability are complicated further by the fact that no operator has access to the prior year porting volumes of its competitors. Although this information is not required in order for any operator to set its own day/evening/weekend rates (as the TAC will be used as a proxy), it will affect the revenue a recipient operator actually receives from a donor operator. This is because in a 'donor passes all' scenario the revenue received by the recipient operator will be determined by the day/evening/weekend rates set by the donor operator, which in turn will be based on the ported traffic volumes of that donor operator.

Orange is wary that these potential complications and vagaries may provide 900MHz/1800MHz operators with grounds to object to the formula, as they may feel that an operator's AIC in any particular year does not necessarily represent actual porting volumes or network costs. However, Orange does not believe that this is likely to have any greater adverse impact on 900MHz/1800MHz operators than any others and it is an unavoidable consequence of constantly altering traffic patterns.

Any originating operator could object to the fact that the day/evening/weekend rates that it will pay may not precisely reflect the costs of terminating that particular call at that particular time and this will affect Orange as much as any other originating operator. Overall, however, the average charge paid for terminating all directly routed and ported minutes will far more accurately reflect the average costs, than it does currently. On that basis, we do not believe that such objections are valid.

Orange is therefore satisfied that the amended compliance formula proposed by Ofcom represents the best available balance between what is reasonably fair and accurate (by way of allowing





operators effectively to charge their TAC on ported in minutes) and what can practically be implemented (bearing in mind that the operators do not have access to each others ported traffic volumes and future termination charges, as Ofcom as highlighted). It is not perfect, but it represents a significant improvement on the current situation.

Orange would briefly note that Ofcom's proposals will not take into account the 7 new operators that are currently working towards offering MNP and any other new entrants that may subsequently join. This is, of course, because the termination rates of those operators remain unregulated and so their day/evening/weekend rates cannot be adjusted and they have no TACs to be used to correct any over or under recovery. For as long as their termination rates remain unregulated there appears to be no solution to this problem.

Orange is also satisfied with Ofcom's proposals for taking account of the fact that these amendments to the charge control are likely to come into effect part-way through the first year of the charge control. This will require some fairly complex calculations which will make setting day/evening/weekend rates and calculating the AIC even more challenging. However, it appears to be the most pragmatic and equitable solution to the problem and Orange certainly would not support any delay to implementing the amendment as an alternative.

Therefore, taking everything into account Orange can see no better alternative to option 4, either in the options outlined by Ofcom or any other possible option. We therefore strongly recommend that Ofcom proceeds to implement option 4 without delay in order to go a large way to resolving an inequitable situation which has existed for far too long.