The Phone Co-op Limited

The mobile industry: Mergers should prompt complete re-regulation

FCS Comms Provider

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Time to re-regulate the mobile industry

- Current wave of mergers should prompt a completely fresh look at the regulation of the mobile industry
- Mobile market regulation has its origins in an entirely different situation from fixed line – the need to encourage investment in new infrastructure
- The industry is now essentially mature and regulators need to look forwards rather than backwards
- If we don't change there is a real risk of contradictions as fixed and mobile converge
- MVNOs have a key role but are being prevented from fulfilling it
- Mergers are adding to this problem

The context

- Vertically integrated oligopoly in mobile
- In fixed line, BT Openreach has a monopoly in infrastructure in most areas and is dominant at retail level
- BT/EE merger would create a monster – biggest mobile operator with near-monopoly on fixed infrastructure
- O2/Three merger would reduce MNOs to three

Why is regulation important?

- Regulation might seem boring and bureaucratic, far from the commercial cut and thrust
- Regulation has been the foundation of the telecoms industry since privatisation
- It has opened it up to competition, and allowed new entrants
- Without it, we would not have the industry we have today

Fixed and mobile regulation had different starting points

- **Fixed:** the aim was to break BT's monopoly as a service provider and encourage new entrants to use their infrastructure
- **Mobile:** it was to encourage new networks to be set up, with massive investment in new infrastructure
- We are still living in the shadow of original rationale

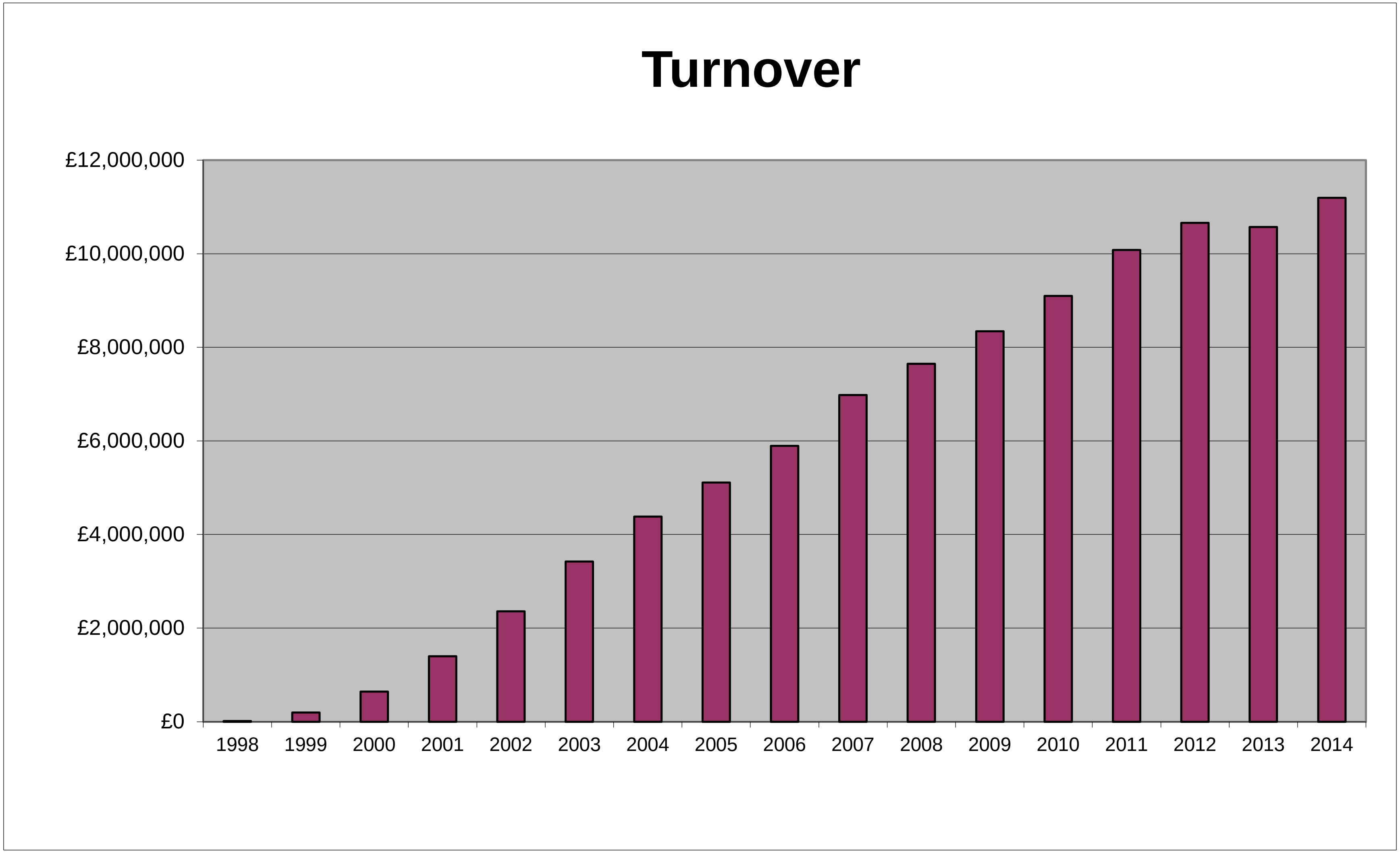
Moving beyond the early framework

- In both fixed and mobile, things have changed
- In fixed, policy is increasingly focused on internet access
- In mobile, the networks are well-established
- In both fixed and mobile we see regular heavy investment in new technology
- Networks are converging in a number of ways

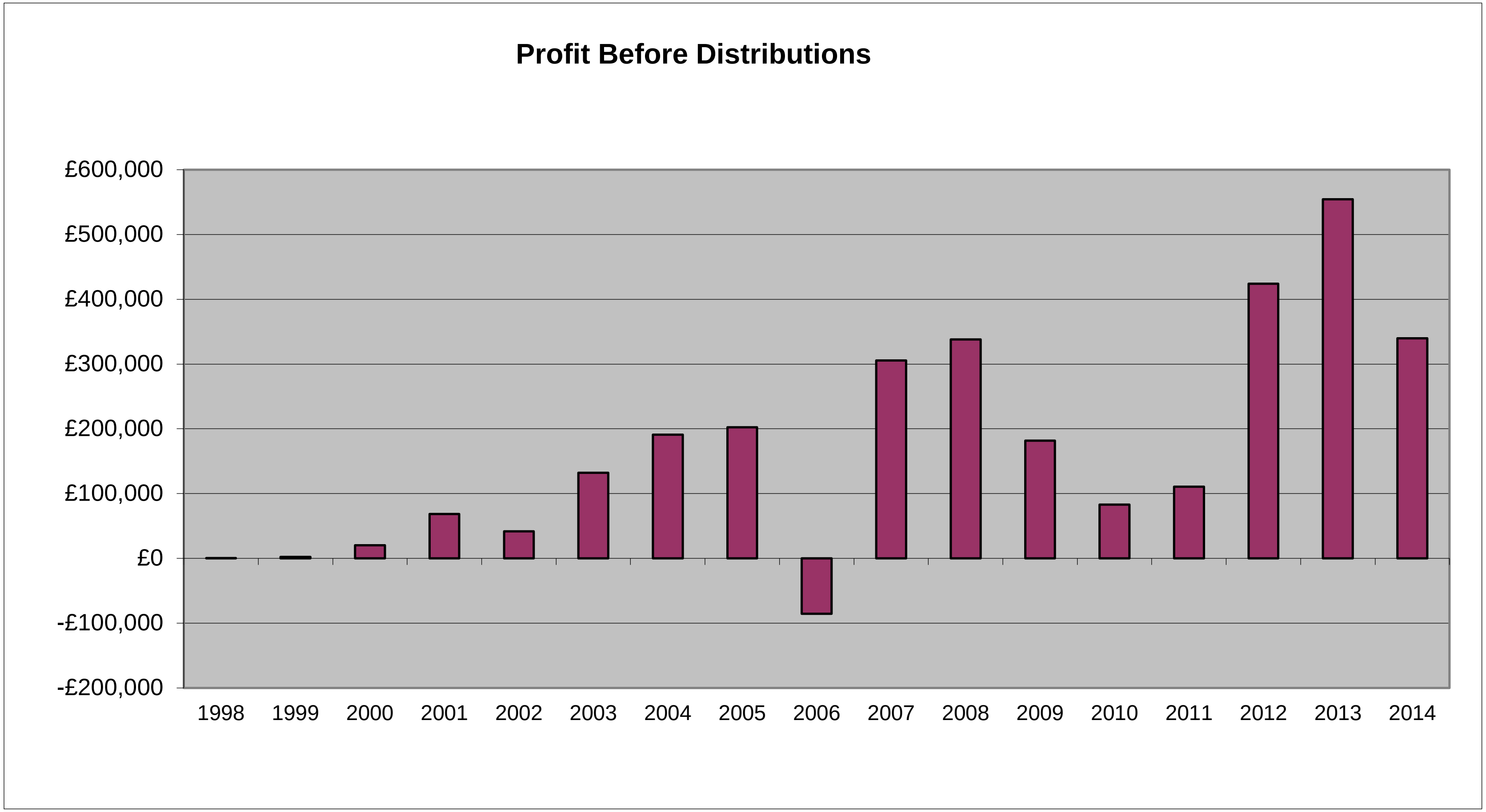
The Phone Co-op – a consumer champion

- The Phone Co-op is unique
  - A service provider owned and democratically controlled by its customers
- 30,000 residential and business customers
- Over 11,000 members
- Shares our profit with members through a dividend on spend
- 17-year trading history
- We can claim to be a consumer champion

The Phone Co-op Limited



Profit before Distributions



Different starting points but we need to regulate for the future not the past

- Mobile had a different starting point to fixed line
- Initially, as new entrants, mobile operators needed to see a good return on their investment to encourage them to roll out networks across the country.
  - This meant allowing them to charge high prices and recover their investment fairly quickly.
- Now, the cost of mobile infrastructure is arguably lower than that of fixed line, the operators' offers are very similar.

Convergence, not just of technologies

- But it is not just the technologies that are converging
  - The market positions of the dominant players are also becoming more analogous
- Growth of co-operation at network level between operators means network infrastructure is increasingly integrated – not quite another Openreach yet but heading that way
- Arguably there are now just 2 mobile networks
- If O2/Three merger proceeds, a single infrastructure (for some!)

Market convergence

- Emergence of an oligopoly in residential service provision in fixed line as well as more generally in mobile, with vertically integrated providers offering increasingly similar packages
  - The role of smaller service providers is under threat in fixed line, especially in the residential market
- Regulators at European level as well as nationally should think hard about whether this is what they really want. SPs have an important role to play

Why are independent service providers important?

- SPs understand the market
- In fixed line, they have real pricing leverage with networks
- SPs can innovate with tariffs, distribution methods, customer service and technical integration with applications
- SPs provide choice to end-users

The role of MVNOs

- Analysys Mason in 2008: “Network operators retain significant power over service providers since the network operators are suppliers to service providers and are also service providers themselves. There is therefore little incentive for mobile operators to negotiate a deal in favour of MVNOs”
- Own early experience when talking direct to an MNO: Not interested unless you are Tesco.
- Aggregators have helped but choice is very limited

The role of MVNOs

- Operators acknowledge they work with MVNOs who don't pose a threat
  - Head of FT Wholesale at Berlin conference was clear
- There are significant barriers to entry for MVNOs
- Most entrants have to work through one of very few aggregators
- MNOs are effectively discouraging/managing competition from MVNOs

Common barriers to entry for MVNOs

- High set up charges
- High monthly charges
- Uncompetitive wholesale rates (can be above retail)
- Lack of choice (some MNOs don't do MVNO)
- Insistence on exclusivity/restrictive clauses

More barriers to entry for MVNOs

- Requirement to buy from aggregators
  - Again little choice
- Contracts weighted against the MVNO
- Limited security of supply
- Uneconomic costs for SIMs

Why do MVNOs face these barriers?

- Most developed markets are effectively licensed oligopolies, becoming more like monopolies over time
- MNOs have no real interest in sharing the market with anyone else
  - They see MVNOs only as a vehicle to gain market share from other MNOs
  - This is not a genuine wholesale market because MNOs are conflicted. That's what regulation is designed to fix in the fixed line market

Separation of mobile infrastructure and service provision

- We should work towards the separation of network operation and service provision.
  - The vertically integrated model entrenches oligopoly market power which reduces choice to consumers and limits innovation in service provision
- Of course network operators could still be service providers (originally they couldn't when analogue mobile operators started in the UK) – but they should be required to offer wholesale access to other SPs, and this should be regulated.

How this could work

- There would be a single infrastructure from a commercial point of view, with multiple owners
- SPs would pay to use the network would be at a standard, regulated rate. Actual owners would receive payment when their infrastructure was used
- A common, regulated interface between infrastructure and service providers

How this could work

- Anyone should be able to operate infrastructure, subject to meeting the technical specifications.
  - This would encourage better coverage
  - Specialist MNOs would fill “Not spots” that the big networks don’t find economic or haven’t reached. Some of these could be community owned
  - A community would place a different value on being connected than the MNO would place on connecting them

How this could work

- Anyone could be a service provider
  - – the term “MVNO” would be redundant in this scenario
- The price SPs would pay to use the infrastructure would be calculated using the same principles as interconnect pricing is determined in fixed line, i.e. to allow network owners to make a defined level of profit from an efficient operation.

Advantages of a single infrastructure

- Would remove the concept that networks compete on coverage
- Coverage for everyone would be improved
  - Does it make sense that many M2M providers are using non-UK networks because roaming coverage is better than that provided by individual networks?
  - Demonstrates that current regulatory framework is failing to meet market needs
- People would not be forced to choose a provider simply as a result of the coverage available where they need it
  - A hidden form of real "SMP"

Advantages of a single infrastructure

- Instead of focusing on coverage, the emphasis would be on SPs differentiating themselves in other ways
- This would increase choice, open up competition and innovation at different points in the value-chain, and encourage improvements in price and quality

CPS on mobile networks

- For as long as traditional telephony remains important:
- CPS should be introduced on mobile networks
- Users/SPs would be able to select the carrier they want to terminate their calls, opening up a whole new market, with many carriers and resellers well-placed to enter it
- Would mean MNOs couldn't charge excessive prices for certain types of calls
  - They certainly do at the moment – e.g. PRS/Non-Geo/many international calls)
  - Would be a better solution than the Access/Service charge split Ofcom brought in which isn't working

Indirect access/CPS - implications

- This change would mean that costs of call origination on mobile networks would become more transparent, and would be regulated, just as ingress costs are in fixed line.
  - At the moment there are wholesale charges for this, but MVNOs have nothing objective to use as a benchmark
- It would hasten the end of handset subsidies

Increasing competition in mobile broadband

- In the mobile broadband arena, operators should be required, as BT is in fixed line, to offer L2TP interconnection, thus enabling other ISPs to sell services over any mobile connection, at a regulated price
  - MVNOs often face uneconomic wholesale data costs
- Would enable ISPs to offer services seamlessly across fixed and mobile, driving the benefits of convergence
  - Currently there is asymmetry in this market

Impact of current mergers

- BT/EE and O2/Three – reduces potential networks from 5 to 3
  - BT has a 4G license – did they bid just to enhance their value? If so hardly a “bona fide”
- A reduction to three networks means each is less likely to want to support MVNOs to avoid cannibalising their own base

FT Weekend

Magazine Billionaires living the Chinese dream | Lunch with the FT Jed Rakoff, the judge holding Wa
UK £3.50; Channel Islands £3.80; Republic of Ireland €3.50
SATURDAY 12 SEP

Cameron plays outfield role in Belfast crisis

David Cameron yesterday urged Northern Ireland's politicians to go the "extra mile" to resolve the province's worst political crisis in a decade, as the prime minister fended off criticism over his decision to watch cricket at Headingley rather than fly to Belfast.

"Geoffrey Boycott has been after me for about three years to come to Headingley and I've always wanted to come, as a cricket fan and somebody who's watched Headingley Tests over the years on the TV," Mr Cameron said.

"But I'm never more than about a yard away from my phone or BlackBerry so if you need to get back for anything I will do that straight away."

Stu Forster/Getty Images

EU crackdown on telecom mergers

- Threat to Hutchison's £10bn move for O_2
- Brussels thwarts tie-up of Danish operators

DANIEL THOMAS — LONDON
ALEX BARKER — BRUSSELS

A £10bn deal to create the UK's biggest mobile operator faced a stiff new challenge yesterday after the EU's competition watchdog toughened its stance on telecoms mergers.

The threat to Hutchison's acquisition of O_2 from Spain's Telefónica came after Brussels thwarted a long-touted tie-up between two Danish operators, saying it would push up prices for consumers.

Margrethe Vestager, the EU's antitrust chief, claimed credit for scuppering the merger, which did not meet her stringent regulatory conditions.

Analysts said the failure of the Danish deal marked a big shift in the European Commission's stance on phone company tie-ups. It comes after a two-year flurry of dealmaking that has remade Europe's telecoms industry, with operators buying rivals to increase their pricing power in several national markets.

The shift sets a daunting hurdle for Hong Kong-based Hutchison as it launches the formal process to clear its acquisition of O_2.

The group filed the paperwork for the deal yesterday afternoon. The commission is concerned that consumers will pay for industry consolidation through higher prices and reduced competition.

Such concerns forced Telenor and TeliaSonera yesterday to withdraw a merger of their Danish businesses, which would have reduced the number of telecoms groups in Denmark from four to three.

That has implications for the Hutchison-O_2 deal, which would also cut the number of big operators in the UK market from four to three.

However, Hutchison is expected to argue that the UK is different to Denmark, where the proposed merger of the second and third telecoms groups would have taken the country close to a duopoly.

Shares across the telecoms market fell almost 2 per cent yesterday as investors worried about the impact on the next wave of mergers. Significantly, Ms Vestager said Telenor and TeliaSonera could only have won approval by shedding assets to create a fourth mobile network operator in the country.

> It is feared consumers will pay for industry consolidation through higher prices and reduced competition

Analysts at Citigroup said the Danish case would raise questions over proposed deals awaiting regulatory clearance, as well as potential deals in the future, for example in France.

"It is not clear what remedy offer would have been acceptable to the commission, if any," Citi said.

"We consequently see this as a toughening of the policy towards in-market mobile consolidation."

Party propaganda sees 'bright future' for China

China's economic data for September will not be collated until next month, but the Chinese Communist party has already decided it will be good news. The focus for the month of September ...

If you've given it then flaunt it, City's wealthy philanthropists are urged

HARRIET AGNEW
CITY CORRESPONDENT

Few rich bankers have dared flaunt their wealth since the financial crisis. But the City's elite are now being urged to become more like their American peers by casting aside discretion when it comes to giving away their wealth.

The widening gulf between rich and poor means that "giving should be done in a far more public way", according to Giuseppe Ciucci, chief executive of Stonehage Fleming, which manages the wealth of rich families. He said: "Unless ... paying taxes and giving back to society — in the same way that big companies have been encouraged to improve their corporate social responsibility.

"It doesn't matter if it's public or private. The important thing is that wealthy families give their money away. If they don't show what they have done publicly then they need to round it up and say that they gave X per cent to charity," he said.

This week City figures including hedge fund manager Sir Michael Hintze raised about £4m for charity abseiling down the Walkie Talkie, the Gherkin ...

Mike de Giorgio, chief executive of the Greenhouse Charity, said banks were nervous about "blowing their own trumpet" because of the "nasty bankers" media coverage they received.

The UK's reserved approach to charitable giving is in stark contrast to the more ostentatious manner of philanthropy across the Atlantic.

Margaret McCabe, chief executive of charity Debate Mate, said: "In the US, philanthropy is considered actively part of their culture — almost part of social justice. In the UK, we've always had a secretive attitude towards money."

Briefing
- Russia ...
- Kuwait ...
- Japan ...
- US sh...

Reducing number of networks to 3 brings real problems

- “Germany, Austria and Ireland have all crossed this threshold, generally seen as the point at which competition ceases reliably to operate”
- “For all the advantages dangled by the purchasers, the result has been as simple as it was expected: prices have gone up”.
  - – Financial Times, 15 September 2015

Auctioning licenses for vertically integrated oligopolies in mature markets?

- Would we expect this for supermarkets, cinemas, petrol stations?
  - Think how much money the Government could raise! But it would lead to less choice and higher prices
- Elsewhere (rail, pubs) the push has been against vertical integration
- Would we tolerate an auction of such significant power in any other market?
- We've been blinded by the history

We need a new conceptual framework

- Current Ofcom definition of “significant market power” is flawed
  - At the moment it really means **overwhelming** market power
  - It’s a technical definition covering limited situations
  - It’s binary: it either exists or it doesn’t
  - Needs to be widened to cover oligopolies and large vertically integrated providers where **excessive market power** exists
  - i.e. account should be taken of overall impact of the operator, not just its impact at a particular point in the value chain

We need a new conceptual framework

- Fixed-mobile convergence means the future risk that Ofcom will start regulating the two as one (i.e. to consider the whole competitive environment encompassing both technologies).
  - This could result in them deciding to end the requirement to interconnect since BT could argue that they are treating Openreach more harshly than MNOs
- By allowing this inconsistency to develop, Ofcom is putting at risk the regulatory framework for fixed line

Why not keep the framework as it is?

- Unless Ofcom changes its conceptual framework, between fixed and mobile may lead it eventually to conclude that there is sufficient competition in the combined space (6 network operators/infrastructure owners) for them to free BT completely from a requirement to supply wholesale and for the access requirements for interconnect to be taken away
- BT just criticised the US market structure on those grounds
- The current arrangements are asymmetrical, and therefore inequitable to fixed line service providers

Low income users would benefit from re-regulation

- The way the MNOs price their services to different people is fundamentally socially inequitable.
- Many people are unable to get contracts and most MNO and many MVNO prepay services are priced at a high level
- More price transparency would address this unfairness

Low income users would benefit

- It is mainly less well-off people (as well as children and low volume users such as pensioners) who often end up on expensive pre-pay tariffs.
- This is not a feature of the fixed line networks, and the early evolution of calling cards etc. actually helped lower income people.
- Opening up the industry would make pricing more equitable

Conclusion

- The time has come to think “out of the box”
- In the past the UK led the way in telecoms regulation
- Ofcom now appears tired and toothless
- Big operators appear to have “captured” regulators
- Breaking the vertical oligopoly model and moving to a clear separation of the different parts of the value-chain, with competition in each, would give Ofcom the chance, once again, to be in the vanguard of regulation globally.

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