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Telefónica UK's response to Ofcom's Consultation on Wholesale Voice Markets 2021 - 26

Telefónica UK Limited
260 Bath Road
Slough
Berkshire
SL1 4DX
T +44 (0)113 272 2000
www.telefonica.com

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1. Executive Summary

1.1 Telefónica UK is one of four mobile network operators in the UK. We offer mobile communications solutions to over 25 million residential and business customers through our O2 and giffgaff brands. We also provide wholesale access to several mobile virtual network operators, including Sky, Lycamobile and Tesco Mobile.

1.2 Our interest in this market review lies primarily in relation to Ofcom's proposals relating to:

- regulation of mobile call termination (MCT) for UK calls;
- regulating international calls on a reciprocity basis, and;
- the continued application of mobile termination rates (MTRs) to 070 calls.

1.3 We summarise our key responses below, with subsequent sections providing further explanation.

Regulation of MCT for UK calls

1.4 We agree with Ofcom's market assessment and proposed regulation. It is important for regulatory stability and beneficial for providers' expectations to maintain the regulation of MCT that has delivered against its objectives over the past years.

Regulating international calls on a reciprocity basis

1.5 We support Ofcom's 'reciprocity' proposal as it provides the best conditions for UK providers to deter the international providers that they negotiate with from increasing their rates. Ofcom should be aware of several practicalities when deciding on and designing this approach for its Statement.

Continued application of MTRs to 070 calls

1.6 We welcome Ofcom's proposal to continue the application of MTRs to 070 calls as this has led to a significant decrease in fraudulent use of 070 calls. Telefónica UK has taken the lead in passing through reduced 070 wholesale rates in lower retail charges. We expect other mobile providers to follow our example. Where mobile providers continue to charge their customers well above MTRs for 070 calls, Ofcom should consider intervening in order to protect these consumers.

1.7 If legitimate use of 070 numbers remains low, Ofcom should consider making these numbers available for mobile use in order to give effect to its regulatory duty to ensure efficient use of scarce numbering resources. The strong association that UK consumers have of these numbers being mobile numbers makes this a natural step.

2. Regulation of mobile call termination for UK calls

2.1 We agree with Ofcom's proposals to define relevant markets as termination services provided by a given provider for the termination of voice calls to UK mobile numbers under that provider's control, and to find each provider (hereafter: MCT provider) to have SMP in relation to the markets where it has full control over termination to mobile numbers.

2.2 Ofcom's market assessment has not changed from previous reviews. It is beneficial for regulatory stability and providers' expectations that market definition and SMP determination are not changed unless material developments in relevant factors justify such changes. Importantly, this assessment enables Ofcom to impose regulation that is non-discriminatory and avoids distortion in retail mobile markets.

2.3 Ofcom proposed three remedies to address SMP in markets for MCT:

1. a network access obligation on all MCT providers;
2. a charge control (without a price notification obligation) on calls originating in the UK on all MCT providers, and;
3. regulating international calls on a reciprocity basis.

2.4 The remedies proposed by Ofcom are the same as the requirements that currently apply, except for the proposals to no longer include a price notification obligation and to regulate international calls on a reciprocity basis. We discuss Ofcom's proposals for regulating MCT for UK calls in this section, then comment on Ofcom's proposal for regulating international calls in the next section.

MCT network access obligation

2.5 We support Ofcom's proposal to continue to require MCT providers with SMP to provide network access on reasonable request and on fair and reasonable terms and conditions. This requirement ensures that all communications providers can offer their customers end-to-end calls to all UK mobile numbers, thus supporting competition in UK retail communications markets.

No MTR reporting requirements and accounting remedies

2.6 We agree with Ofcom's proposal to remove the obligation on MCT providers to annually notify Ofcom of MTRs they charged in the previous charge control year. As Ofcom has not relied on this information significantly for the purpose of enforcement and can use its formal information gathering powers to examine the rates that providers charged, there is no need to maintain this obligation. Similarly, we agree that imposing accounting separation and cost accounting remedies on MCT providers would not be proportionate.

MCT charge control

Rationale for a charge control and relevant cost standard

2.7 We agree that *ex ante* price regulation remains necessary to promote competition in retail mobile markets, and that a cost-orientated charge control is the most effective way to implement such regulation.

Approach to calculating the MCT charge control

2.8 Ofcom proposed using a bottom-up cost model (the 2020 MCT model) to calculate the LRIC of MCT for each year of the review period. We agree with the light-touch approach that Ofcom proposes for updating its 2018 MCT model. Whilst more extensive updating (including for technology choice and equipment unit costs) could produce different results, the impact on absolute MTR levels is likely small. Recognising the merit of minimising regulatory burden in Covid-19 times where feasible, we believe that Ofcom's approach offers an appropriate level of accuracy and that more detailed assessment is not needed.

2.9 We have a few suggestions for Ofcom to consider in finalising its decisions for the Statement.

a. Ofcom explained that data on unit costs and cost trends of equipment gathered as part of 'the EC's Eurorates modelling' is not fit for purpose. This being the case, it decided to not update its modelling for equipment unit costs as the data it holds would not support this and gathering new data would not be appropriate in current circumstances. Whilst we recognise Ofcom's argument that updating cost trend of equipment risks introducing inconsistency in its model, we believe that Ofcom should consider whether it might do more, in terms of assessing whether it could complement the data it currently has by 'light-touch' information checks with MNOs. This would enable Ofcom to provide an indication of what the impact of updating for data on equipment costs would be.

b. Ofcom's proposal for a light-touch update increases the importance of diligent calibration. The explanation that Ofcom gives for the additional cross-checks it has undertaken provides little in terms of justification of how its judgement of being satisfied that its model produces reasonable costs follows from these cross-checks. It would be helpful if Ofcom were to provide more justification in its Statement.

3. Regulating termination of international calls

3.1 In previous reviews[1], Ofcom set a single charge control on wholesale MTRs independent of call origin. The same MTRs thus applied to UK and international calls (whether originating from other EEA or non-EEA countries). The similar approach was applied to termination of calls to fixed lines. Ofcom did not rule out though the possibility, if justified by circumstances, of applying a different level of regulation to calls depending on call origin.

3.2 The current arrangements of the UK, as an EEA country, charging the same rates to terminate domestic calls and calls originating from other EEA countries, will end with the transition period on 31 December 2020. Ofcom correctly identified that ongoing negotiations between the UK Government and the EU can have a bearing on the regulatory framework and that this may impact on what UK providers can charge to terminate calls from EEA countries.

3.3 Whilst Ofcom has previously applied the same cap to termination rates for calls from both *within* and *outside* the EEA, regulators in other EEA countries commonly give 'their' providers some flexibility to negotiate and set charges for terminating calls from outside the EEA (whether in the form of reciprocity or freedom to negotiate prices commercially).

3.4 Ofcom is right to consider, particularly so in current circumstances, whether price regulation on international calls could be relaxed. Depending on the outcome of the UK Government's negotiations with the EU, its preferred approach would apply to all international calls or only to calls from non-EEA countries.

3.5 Ofcom concluded that reciprocity, of the three identified options for regulating international calls, is likely to deliver the best outcome to UK consumers. Reciprocity means that the termination rate charged by the UK provider can be no more than the reciprocal termination rate by the relevant international provider for a call originating in the UK, or the applicable UK domestic rate, whichever is the higher.

3.6 We agree that the preferred outcome is 'low-low', i.e. where both UK and international providers charge low rates for terminating calls originating from the other country. This would lead to lower cost and revenues for providers and would minimise the potential distortive effect that prices may have on call volumes.

[1] 2017 NMR and 2018 MCT.

3.7 Whilst we agree with Ofcom's conceptual assessment and with its provisional conclusion that reciprocity likely delivers the best outcome to UK consumers, Ofcom should take note of the subsequent practicalities when deciding on and designing this option:

- the origin of international calls can be concealed or misrepresented in interconnection markets;
- [✂];
- [✂], and;
- several providers operating in other EEA countries apply mark-ups to termination rates.

3.8 The first two practicalities are related as they concern the capability of UK providers to identify call origin and to charge differing rates for termination depending on where calls originate from.

The origin of international calls can be concealed or misrepresented in the interconnection market

3.9 The options of reciprocity and commercial freedom to negotiate prices would likely result in UK providers agreeing differing termination rates depending on country of call origin. This being the case, some international providers would have to pay considerably more for terminating their calls to UK numbers compared to UK providers (and possibly some other international providers).

3.10 The reality of interconnection markets is that calls can be transferred between differing intermediaries and providers, and that UK providers are commonly not able to observe or validate call origin when calls are handed over to them. The combination of variation in charges and the inability of UK providers to observe and/or validate call origin means that international providers (and/or the intermediaries they work with) will have incentives and be able to achieve lower costs of terminating their calls by concealing or otherwise misrepresenting call origin if this allows them to achieve termination at UK termination rates. This reality applies to fixed and mobile termination alike.

[✂]

3.11 [✂]

3.12 [✂]

[✂]

3.13 [✂]

Several providers operating in other EEA countries apply mark-ups to termination rates

3.14 It is our experience that several providers (typically MVNOs) operating in other EEA countries apply mark-ups to the rates for which they are legally obliged to terminate calls to their mobile customers. When our customers call the customers of these providers, we are charged both the rates they are legally allowed to charge plus mark-ups. Given the scale of call volumes and mark-up by individual providers, we have not, thus far, sought to challenge these providers.

3.15 We would be concerned if these providers, perceiving that they are allowed to add mark-ups to MTRs, are encouraged to continue or possibly to increase their mark-ups to what they charge us for terminating calls to their mobile customers.

3.16 We ask that Ofcom evaluates this practice, reviews the potential legal basis for application of mark-ups could be (if any), and uses whatever influence it has (including liaising with relevant national regulators) to discourage and oppose these providers to add mark-ups where these are illegal.

4. Continued application of mobile termination rates to 070 calls

4.1 Ofcom, as part of its 2018 review of the 070 number range, imposed a cap for 070 wholesale call termination at the same level of MTR. This decision was based on providers having SMP in terminating calls to 070 numbers under their control, a charge control remedy being necessary and proportionate to address harms identified[2], and customers expecting costs of calls to 070 and mobile numbers to be the same.

4.2 We agree both with Ofcom's judgement, that factors underpinning the market assessment and remedy design in its 2018 review remain valid and with considerations around its proposal to continue to apply MTRs as a cap to 070 termination rates. Critically, customers expecting the costs of 070 and mobile calls to be the same and the risk of significant fraudulent use in the absence of regulation, supports the continued application of MTRs as cap to 070 termination rates.

4.3 Ofcom reports that 070 call volumes have decreased by 90%. This aligns with our experience, that scams involving 070 calls have decreased very significantly. Also, it validates our historic position, that the 070 number range, before Ofcom introduced regulation in 2019, was predominantly used for fraudulent purposes exploiting customers' lack of understanding of the charges that 070 calls attracted. The reduction in fraudulent use is good news not only for UK consumers but also for mobile providers as their customers commonly do not understand why they incur higher retail charges for what they perceive to be mobile calls.

4.4 The substantial reduction in the 070 wholesale termination rate has allowed mobile providers to include 070 calls in the call bundles they offer or otherwise to reduce their retail charges for 070

[2] Including high wholesale and retail prices, bill shock and fraudulent use of 070 numbers.

calls. Figure 10.2 of Ofcom's Consultation, however, shows that the extent of pass through varies considerably. Telefónica UK has taken the lead. Both O2 and giffgaff now include 070 calls in their call bundles which means that the post-paid customers of these providers do not incur additional costs when making 070 calls.

4.5 Ofcom suggests that more mobile providers may pass through lower wholesale rates in retail prices over the months ahead as the regulation of 070 call termination only came into effect last year. It would be poor practice and bad for the reputation of the UK mobile industry if some mobile providers were to continue to exclude 070 calls from bundles instead charging their customers well above the wholesale rates for terminating such calls.

4.6 The significant reduction in 070 call volumes raises questions on the benefits of retaining the 070 number range for personal or 'follow-me' numbers. The advance of mobile roaming and other communication technologies (which were not available when Ofcom allocated this number range to such services) has very materially reduced demand for 070 services. If Ofcom finds that demand has reduced significantly and that prospects for ongoing legitimate use remain limited, it should consider making this number range available for mobile consumers. This would end the ongoing consumer confusion around not all numbers starting 07x being mobile numbers.

4.7 In Telefónica UK's view, Ofcom should take a far more robust and purposeful position on this issue. It has intervened to regulate wholesale termination of 070 calls on the basis that originating operators would set the retail price of calls to 070 numbers as if they were calls to mobile numbers. Given that consumers struggle to distinguish between calls to mobiles and calls to 070 numbers, and given the desirability of the option of changing the numbering plan such that all 07 numbers are designated mobile numbers, Ofcom should put pressure on originating operators to price calls to 070 numbers as if they are calls to mobiles. It is not clear to Telefonica UK how signatories to Ofcom's "customer fairness commitments" could reconcile any other retail pricing policy with the commitment to provide fair value.