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Three's response to Ofcom's Narrowband Market Review

1. Please see below for Three's response to Ofcom's consultation on the proposed markets, market power determinations and remedies for wholesale call termination, wholesale call origination and wholesale narrowband access markets, published on 1st December 2016. Our response is focused on those specific consultation questions which are most relevant to Three UK as a mobile network operator and purchaser of fixed wholesale call termination.

Response to Ofcom's detailed questions

Q11.1: Do you agree with our provisional conclusion regarding market definition for WCT?

2. Three welcomes Ofcom's recognition of VoIP bypasses as a wholesale supply-side substitute for fixed geographic call termination. This aligns with Three's experience in mobile call termination in which it is aware of international calling exchanges selling a "PSTN calls to Viber" service.[1] In this situation the calling party will not be aware that the PSTN call made from their native dialler and mobile radio network would be delivered on a Viber client rather than the intended mobile radio network.

3. Ofcom's has stated that it does not consider such bypass mechanisms will be material during the market review period, and as such does not propose to widen the wholesale product market on this basis. Three urges Ofcom to nevertheless monitor the volume of calls being terminated by VoIP bypasses and, aside from its impact on future market definition, monitor any associated consumer harm that may arise from consumers receiving a lower quality calls than would be received via termination on the PSTN network (as the originating caller intended).

[1] For example, see http://telecomsxchange.blogspot.co.uk/2015/09/pstn-calls-to-viber.htmlhttp://telecomsxchange.blogspot.co.uk/2015/09/pstn-calls-to-viber.html

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Question 12.1: Do you agree with the remedies that we propose for CPs with SMP (other than BT) in the WCT markets?

4. Three supports Ofcom's proposal to apply a charge control to all CPs with SMP in fixed wholesale call termination, alongside the existing requirement to provide network access on fair and reasonable request.

5. However, Three does not agree with Ofcom's proposal to impose a price transparency obligation that only requires CPs to give notice of changes to prices on or before the day the change comes into effect. Instead CPs should be subject to the same requirement to notify charges that BT is currently subject to. This would oblige CPs to provide 56 days' notice of any changes to prices taking effect. Such advanced notice of changes to charges is necessary to provide purchasers of WCT with certainty over their costs in the near future and the opportunity to adjust their own retail offerings accordingly.

6. Ofcom has justified its decision by reference to its proposal to apply the charge control to all CPs and its expectation that all CPs will price at the cap, thereby making advance notice unnecessary. [✂].

7. The absence of a notice period will impair purchasing CPs' ability to detect non-compliance with the charge control in advance, thereby limiting their ability to take mitigating action before detriment is allowed to occur (such as excluding calls to the terminating CP from a customer's monthly call allowance). An ability to take such action in a timely manner could result in an under recovery of costs by the purchasing CP.

Question 12.2: Do you agree with the remedies that we propose for BT in the WCT market?

8. Three supports Ofcom's proposal to maintain the following remedies on BT, in addition to those which apply to all other CPs with SMP in fixed WCT:

    - requirement not to unduly discriminate;
    - requirement to publish a Reference Offer;
    - accounting separation; and
    - cost accounting.

9. However, for the reasons set out in paragraph 5 above, Three does not agree with Ofcom's proposal to replace BT's existing obligation to notify charges 56 days in advance, with a price transparency obligation which would only require BT to notify charges on or before the day in which any changes come into effect.

10. Ofcom has justified its proposal to remove the notice of charges condition on BT on the basis that it is extending the charge control to all CPs with SMP in WCT. However, Ofcom has not explained how or why extending the charge control to other CPs would impact on the transparency of BT's fixed call termination charges. For example, BT

would still have the ability to reduce the WCT below the charge control cap without providing advanced notice. Its competitors would therefore be at a disadvantage, compared to BT's own downstream divisions, in reducing retail prices accordingly.

Question 13.2: Do you agree with our proposal to apply the WCT charge control to all calls terminated in the UK irrespective of where the call was originated?

11. Three's experience in mobile call termination shows that there is a marked divergence in MCT rates to calls terminating within and outside the EU, respectively. [✂].

12. To the extent that a similar divergence in call termination rates exists in fixed WCT, Three considers that allowing CPs the flexibility to charge a two-tier fixed WCT rate (for calls originating within and outside the EEA, respectively) has the potential to deliver benefits for UK consumers.

Consumer detriment arising from above LRIC EEA-termination rates

13. Three notes that there are no UK competition grounds for the regulated termination rate to apply to calls originating from CPs outside the EEA (because CPs offering termination services in the UK do not compete with CPs offering termination outside the UK). Furthermore there are harms arising to consumers in the UK, to the extent that the rates above LRIC are being charged to UK CPs for non-EEA termination:

i. **Allocative efficiency** - to the extent that Ofcom considers there is a waterbed (complete or partial), above-LRIC rates for non-EEA termination will distort the retail pricing of international calls (and corresponding volumes). This is expected to result in a transfer of consumer surplus from UK customers to non-EEA CPs. Some customers may be priced out of making international phone calls altogether, despite their marginal valuation for a call lying above of the true underlying marginal cost of delivering this service.

ii. **Dynamic efficiency** – to the extent that there is no waterbed effect, or that the waterbed is incomplete, the asymmetry in termination rates within and outside the EEA will result in UK CPs experiencing a net reduction in revenues. Such a reduction in revenues could reduce CPs ability to undertake investment (if they are capital constrained) or their incentive to do (if it results in returns to international termination-related investment falling below the required cost of capital).

iii. **Dampening of competition on international calling propositions –** above-cost terminations rates for calls to non-EEA countries are likely to have a dampening effect on competition between UK CPs with respect to their international calling propositions. This is because any UK CP which reduces the price of its international calls will experience an increase international call volumes and corresponding termination rate payments. The greater the average termination rate for internationally terminating calls the stronger this disincentive effect is.

iv. **Barriers to entry and expansion** - those customer segments which make a high volume of non-EEA calls will be less profitable than those which primarily make domestic (or within EEA calls). The largest CPs will have access to the call records of a higher proportion of UK retail market, allowing them to tailor their pricing and retention offers to customers depending on their non-EEA call volumes. In contrast smaller CPs and new entrants will have access to far fewer customer call records, reducing their ability to compete in such a way with larger CPs.

14. All three of these effects would translate into detriment for UK customers in the form of reduced access to services, higher prices or reduced service quality. Three believes, based on its experience of the MCT market, that that the ability to charge a differential termination rate to inbound calls from non-EEA fixed CPs would improve the countervailing buyer power of UK fixed CPs w.r.t the price of non-EEA WCT, allowing them to negotiate lower reciprocal rates to a level consistent with LRIC.

Lack of direct commercial relationships

15. Ofcom has stated that a lack of commercial relationships between UK fixed CPs and non-EEA CPs may limit the extent to which UK CPs can negotiate reciprocal FTRs. Whilst Three does not have extensive knowledge of the depth and breadth of contractual relationships in the fixed market [✂].

16. Three would therefore urge Ofcom to review the experience of CPs in EU jurisdictions which do allow a two-tier FTR before fully reaching its conclusion.

Risk of an increase in retail prices for UK consumers

17. Ofcom has flagged its concern that the flexibility to set differential WCT rates for calls of non-EEA origin could result in UK CPs and non-EEA CPs agreeing reciprocal rates above the level currently charged by non-EEA countries, resulting in detriment to UK customers if such increases are passed through to retail prices.

18. Three notes that while this is a theoretical possibility, to the extent that Ofcom believes a waterbed exists, it is not consistent with the incentives of UK CPs. This is because it ignores the impact on a UK CPs' competitiveness with (a) other UK fixed CPs and (b) retail substitutes to fixed calls to non-EEA countries.

19. If a UK fixed CP were to unilaterally negotiate higher reciprocal rates with non-EEA countries, its international calling propositions would be more expensive compared to other UK fixed CPs. In the event that all UK fixed CPs negotiated a reciprocally higher terminations rates, their international calling propositions would still be less competitive compared to retail demand-side substitutes such as international calls made using mobile or OTT services.

20. We note, and support, Ofcom's conclusion for the purposes of market definition that retail demand-side substitute's do not currently constrain fixed WCT. However, this conclusion was reached on the basis of a small but significant non-transitory increase in wholesale call termination prices (typically 5-10% above the competitive level), in accordance with the principles of market definition. Ofcom's specific concern with respect to non-EEA termination is that CPs will agree rates in excess of the highest rates currently charged by countries outside the EEA. [✂] In such a situation it would seem unrealistic to assume the corresponding impact on retail prices would not be

large enough for a material degree of demand side substitution to occur amongst those customer segments which make a high volume of international calls.

Complexity of compliance

21. Ofcom has stated its concern that allowing the differential regulation of FTRs by region of origin would increase the complexity of regulation and may result in disproportionate monitoring and compliance costs. Three notes that Ofcom has already identified a number of jurisdictions in which NRAs have allowed CPs to use a two-tier rate for WCT[2]. Three therefore urges Ofcom to use the experience in such jurisdictions as a case study for the potential impact on compliance and monitoring costs in order to properly evidence this concern.

[2] See paragraph 13.90, page 208 of Narrowband Market Review: Consultation on the proposed markets, market power determinations and remedies for wholesale call termination, wholesale call origination and wholesale narrowband access markets, Ofcom, December 2016.