COLT Telecom Group SA

Response to

ERG draft Common Position on Next Generation Networks
future charging mechanisms / long term termination issues
consultation dated October 2009

10 December 2009

1. INTRODUCTION

This is the response of COLT Telecommunications (COLT) to the ERG's draft Common Position on Next Generation Networks (NGN) future charging mechanisms / long term termination issues consultation of October 2009.

COLT is a leading European provider of business communications to major enterprises, SMEs and wholesale customers, offering a broad portfolio of data, voice and managed services. COLT owns and operates one of Europe's most advanced communications networks in 13 countries, through its 20,000km fibre network connecting around 100 cities, with metropolitan area networks in 34 cities and 18 integrated data centres. COLT complements its own network by the use of off-net connectivity and local loop unbundling (LLU).

COLT notes that the title of the ERG paper is somewhat misleading as the subject matter is entirely focused on an assessment of a migration in the voice market from the current CPNP (Calling Party Network Pays) charging regime to a bill and keep (BAK) regime.

References in this response to the "May 2009 Recommendation" refer to the Commission Recommendation of 7 May 2009 on the regulatory treatment of fixed and mobile termination rates in the EU 2009/396/EC)

2. ASSESSING BENEFITS OF MOVING TO BAK REGIME

The ERG paper assesses that there are a number of benefits of migrating the voice interconnection charging regime to BAK. COLT has a number of comments on this assessment, casting serious doubt on the conclusions drawn by the ERG.

2.1 Falling termination costs

It is true that markets have generally seen a reduction in termination costs, both as a result of true reductions in unit costs (eg. as a result of mobile call volumes increasing disproportionately compared with the underlying cost base) and "artificially" (eg. as a result of regulators choosing to change the relevant methodology for calculating regulated termination charges, including resulting from the May 2009 Recommendation). Such reductions have the effect of decreasing the difference in the results generated by the CPNP and BAK charging regimes but this is not in itself any justification for a move to BAK. While there might be an apparent increasing similarity in the result of applying these two different regimes, this similarity applies only to the headline rates and ignores the other implications and difficulties of amending the relevant charging regime. In addition, while there is a general trend for mobile termination rates to fall, this is not necessarily the case for fixed termination charges where a number of countries have seen increases in termination charges recently, notably in the UK, Germany, Austria and Finland.

2.2 Lower regulatory costs

It is claimed that a move to a BAK regime would generate far lower regulatory costs, mainly because it would reduce the complexity and effort for NRAs of having to create and review network cost accounting models. However, this benefit is unlikely to be significant in practice and, even if it were to be significant, it is doubtful whether this stands up as an appropriate justification for such a substantial change in regulatory approach.

While it is still too early to judge the exact impact of the May 2009 Recommendation, it seems clear that NRAs following the recommended approach to calculating termination charges should find that the exercise of modelling network costs to establish regulated termination charges will be significantly less complex than has previously been the case. In addition, moving to a BAK charging regime for voice termination charges will not relieve NRAs from the task of producing and reviewing network cost models because these will continue to be required for a large range of other regulated services, such as call origination, data services, leased lines and other wholesale services. Therefore, the difference between the regulatory cost savings from a move to a BAK charging regime (with a continued requirement on NRAs to produce and review network cost models for other regulated wholesale charges) may actually be very small compared with the continued application of the CPNP regime (but based on the cost methodology set out in the May 2009 Recommendation).

On the other hand, COLT foresees that a move to BAK will require NRAs to undertake a number of non-trivial regulatory tasks, such as agreeing the boundaries for BAK (ie. the appropriate number of POIs) and to ensure that the terms and conditions available for transit continue to be fair and reasonable. These additional regulatory tasks will increase the responsibilities and costs for NRAs compared with the situation today.

Irrespective of the regulatory cost differentials discussed above, COLT disputes that this factor in itself is a sufficient or even relevant justification for the proposed move to BAK. The merits of any move to BAK should be considered primarily in terms of the economic and competitive efficiency of any such change, and should not be predicated on the basis of the regulatory costs involved. While such costs are not totally irrelevant, they should be considered as only secondary factors compared with the assessment of different remedies in terms of economic and competitive impacts. Finally, because the financial costs incurred by NRAs will be recovered ultimately from industry, to the extent that regulatory costs are considered as a factor, industry's views on the value of any move to a different remedy (which generates any such additional or reduced cost) should carry significant weight in consideration of regulatory cost levels.

2.3 Removing the termination bottleneck

The ERG paper concludes that a move to BAK will be beneficial because it will remove the effect of the call termination bottleneck; cost recovery being removed from the termination bottleneck and costs then being recovered from the access market which is competitive. However, there is no discussion of whether the assumption as to the competitiveness of the access market is a reasonable one to make or whether any such competitiveness is likely to be sustainable. The competitiveness of the access market is constrained by a number of factors and its sustainability is questionable in light of the future development of NGA networks. One example of constraints is in the mobile sector which is characterised by oligopolistic behaviour and significant restrictions on access to mobile resale opportunities (mobile resale generally not being subject to any regulation in the EU), particularly for smaller niche players, such as operators specialising in business services. In the future, the development of NGA networks may lead to the re-monopolisation of fixed access in the absence of new regulatory measures (which are currently very uncertain), as LLU becomes obsolete and SLU remains uneconomic.

2.4 Bundled pricing

One of the perceived impacts of a move to BAK is that this will extend the availability and scope of bundled pricing packages for voice services. There are numerous instances in the ERG paper where it is asserted or assumed that such an increase in bundled pricing packages will be beneficial for consumers but there is little detailed analysis of what specific benefits will accrue. While it would clearly be beneficial for pricing packages to be made available for customers that are simpler and provide enhanced value for money, it is not obvious that merely having more and wider pricing bundles would necessarily achieve these aims.

Pricing simplicity is a difficult goal to achieve and a move to bundled pricing is no panacea. We can observe from the mobile sector, where bundled pricing has been available for some years, that the variety and number of different pricing bundles makes it very hard for consumers to understand their own bundles in any detail, let alone to make an informed choice from amongst the very many different packages available. There is also the risk of “bill shock” when customers use minutes which are not included within the bundles, particularly as such calls often attract disproportionately high call charges. All of these factors have an impact on the freedom with which customers use their communication devices. While the introduction of BAK might seem likely to reduce the number of out-of-bundle destinations because most call types will attract the same termination charge (ie. a zero charge), many mobile operators already exclude from their bundles call types with zero or very low termination charges, specifically calls which are routed to alternative calling platforms. Introducing BAK is highly unlikely to alter the design of these bundled packages and therefore there will still remain a considerable number of out-of-bundle destinations, with all of the customer confusion and restrictions on call volume growth that this causes.

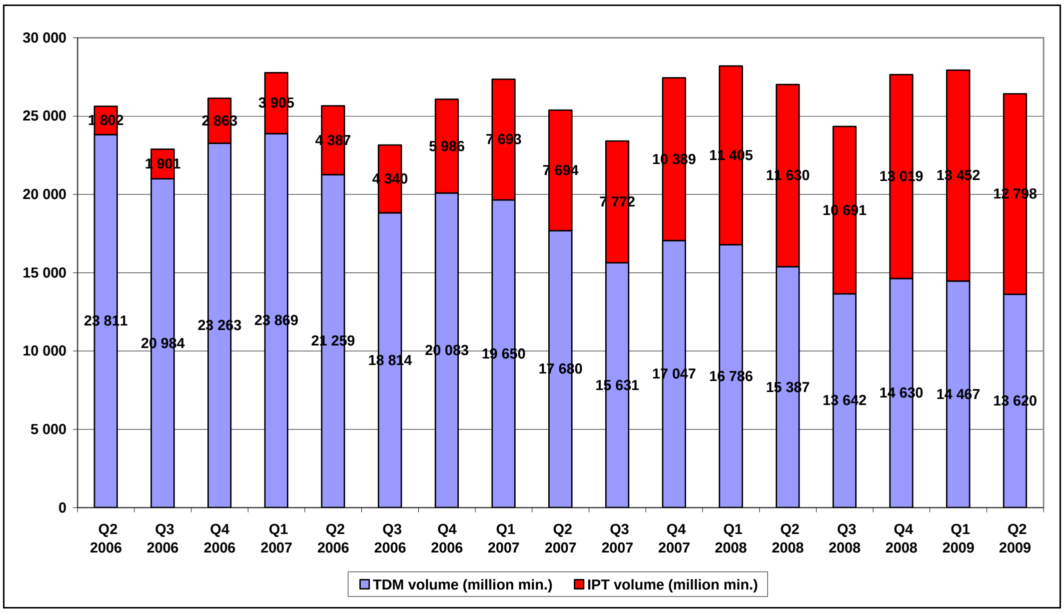
Moreover, the prevalence of bundled pricing packages in the mobile industry demonstrates that such a pricing approach is not dependent on the introduction of BAK to replace the current CPNP termination charging regime; BAK merely making it less risky for providers to offer such bundles.

The ERG paper sees a potential move to BAK as being highly likely to drive significant growth in volume usage, presuming that this behavioural change will in itself be economically beneficial. However, there is a lack of evidence or analysis to support this presumption. There is evidence that free or very low prices can encourage inefficient network use, generating artificial peak traffic surges, with harmful congestion effects which require additional investment to resolve. Finally, it is doubtful whether the encouragement of widespread bundled pricing will necessarily lead to very significant call volume growth. There is strong evidence from the mobile sector and from VOIP usage indicating that there are limits to increases in voice usage, even when very large pricing bundles are prevalent.

The following example from France is instructive. After the development of full local loop unbundling, there was strong growth in IP telephony (sold as part of a fixed price triple play bundle, combining IP telephony with broadband internet and IP TV) which rose from 7% to

48% of fixed telephony volumes. TDM telephony (sold with a per call and per minute charge) declined from 93% to 52% of fixed telephony volumes. Critically, however, total fixed voice call volumes were flat (after seasonal adjustment) in 2006-2009, clearly showing that, although customers might prefer fixed price call bundles to per-call and per-minute billing, such customer preference does not lead to an increase in the total number of calls made.

France fixed voice telephony volumes 2006-2009 (source: ARCEP)



3. ASSESSING RISKS OF MOVING TO BAK REGIME

The ERG paper discounts too freely the possible risks of moving to a BAK charging regime. In particular, the ERG needs to pay additional concern to the possible problems arising in the transit market, the risks of significant SPIT (SPAM over the internet) problems and the threats to the end-to-end quality of service for voice.

The ERG paper assumes that there will be a minimal impact on the transit market. However, in a market which uses BAK as its interconnection charging regime, there are likely to be many more providers of voice services. Transit will become much more important even than today as most voice providers will not have the scale to justify direct interconnection. However, the market for transit services has largely been de-regulated (or is in the process of being de-regulated) in most EU countries, giving rise to significant fears of anti-competitive behaviour. NRAs may need to be much more interventionist in this market in terms of agreeing the boundaries for BAK (ie. the appropriate number of POIs) and to ensure that the terms and conditions available for transit continue to be fair and reasonable.

The ERG Paper disregards the threat of increased SPIT (with only a short footnote remarking that SPIT could become more acute), based on a reliance on possible enhanced consumer protection measures and the ability of consumers to cut short unwanted calls. This seems a very cavalier attitude to what is a very serious consumer concern. Moreover, any substantial increase in SPIT will have a very damaging impact on call utility, something that should be a very significant concern for ERG, given the importance attached in the paper to the benefits that BAK could bring in terms of increased average usage and the consequent economic welfare gain. If the ERG paper does substantially under-estimate the risk of SPIT (which COLT believes it does), then the argument that there will be significant welfare gain from enhanced average usage could be completely negated. The ERG paper also makes reference to an Analysys Mason study which is stated to compare the evidence of SPIT in BAK countries as compared with CPNP countries. However, these comparisons are flawed and the study can not be relied upon in the way suggested because there are no countries that operate a true BAK system; thus the comparisons made can only apply to a lesser version of BAK (see further discussion below).

One of the greatest problems that could arise in a BAK environment is that the quality of voice service could suffer significantly. As the ERG paper itself suggests, the introduction of BAK is likely to lead to substantially lower prices for voice calls. Even if, as the ERG paper states, voice providers would continue to have an interest in the quality of service of voice calls because their customers would make outgoing calls, there would be significantly less revenue on average to support the network infrastructure necessary to carry those calls. Moreover, the nature of the competitive market will mean that a commodity service (such as voice would then become) would gravitate to the lowest common denominator, ie. poor quality voice services would drive out higher quality voice services because those providers having to charge higher prices to recover their investment in quality would lose market share. No provider would want to invest in additional network infrastructure to maintain voice quality if they stand no chance of receiving additional revenue to fund the investment. The end result could be an all-round degradation in the quality of voice services and this too would have a strongly negative impact on the utility of voice services, such that BAK could end up having a significant welfare loss rather than a welfare gain, as posited in the ERG paper.

4. MARKET EFFECTS

The ERG paper describes the likely subsidy payable from a “BAK domain” to external CPNP areas and the likely effect this would have to increase the prices payable within the BAK domain. Given this effect, any decision to move to BAK should be made across as wide an area as possible (in order to minimise this effect) and probably should only be done on a completely pan-EU basis. Even then, there is still likely to be a substantial cross-border effect (for traffic flowing between EU countries and countries outside the EU), restricting to some extent possible welfare gains from the move to BAK.

COLT also highlights the fact that the ERG paper does not discuss in any detail some of the possible wider market effects from a move to BAK. For example, it is possible that a move to BAK which reduces the price differential between mobile and fixed voice calls would generate an even more rapid migration of voice services to mobile. In such a situation, NRAs might have to pay closer attention to the regulation of mobile access so that providers without mobile networks could guarantee gaining access to those networks, either on the basis of the existing MVNO / service reseller model or some other model (eg. over the top VOIP). Other significant market effects could arise in terms of the de-valuing of carrier pre-selection as a competitive model and the impact of BAK on the market for premium rate and information services. The ERG needs to investigate these possible market effects in considerably greater detail before pursuing any plans to move to BAK in the near future.

A critical point that arises from discussion of these market effects is that any introduction of BAK will generate considerable market uncertainty. This is quite the opposite of what the ERG paper argues; far from a BAK regime introducing more certainty, there will be substantially greater uncertainty and unwelcome market instability.

5. FULL BAK OR MOBILE BAK

A final but very important consideration which is not made truly transparent in the ERG paper is that the comparisons made with so-called BAK countries are not accurate. To COLT's knowledge, there is no country in the world which operates a true BAK regime. The main examples given in the ERG paper of the USA, Singapore and Hong Kong do not operate true BAK charging regimes. What these countries operate is a regime which one might refer to as 'mobile BAK", where a termination charge is paid but all calls attract only the termination rate applicable for a standard fixed call (or a bilaterally agreed standard rate), ie. crucially there is no higher termination charge for calls to mobiles. It is noteworthy that much of the discussion in the ERG paper focuses on mobile calls, particularly in the section on empirical data, where the main source is the Merrill Lynch Interactive global wireless matrix. COLT suspects that the problem which the ERG wishes to address is the problem of high mobile termination charges rather than the wider question of what the appropriate interconnection charging regime should be for all communications services in the future, fixed and mobile. This suspicion seems to be confirmed by the fact that the ERG paper contains almost no discussion of the applicability or otherwise of the proposed BAK regime on data services.

COLT requests that the ERG should make clear its aims in considering a move to BAK. If the real issue is that of high mobile termination charges, then the ERG should address this problem specifically. If it believes that BAK is a possible solution to the problem of mobile termination, then the ERG should consider a move to "mobile BAK" and not widen the scope of any suggested solution to true or full scale BAK, where no termination charges would be payable for any voice calls.

6. CONCLUSIONS

The ERG paper does not makes a compelling case for a move to a BAK charging regime; there being little supporting evidence for the conclusions drawn in the paper and, where evidence is presented, much of this is flawed. On the contrary, the suggested benefits for the proposed move to BAK are questionable and exaggerated, and the ERG paper has too readily discounted or failed to address the possible disadvantages and difficulties of such a move, including possibly significant market effects, and that the comparisons made with so-called BAK countries are not accurate as these countries do not operate true BAK regimes. Finally, COLT notes that the ERG paper seems very focused on the issue of mobile termination rates. If the proposal of a move to BAK is intended to address this issue, COLT requests that the ERG should only consider "mobile BAK" and should not seek to consider any move to a full scale BAK regime.

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