

MONDAY 17 NOVEMBER 2008

Present

Bradshaw, L
Eccles of Moulton, B
Freeman, L (Chairman)
Haskel, L
James of Blackheath, L
Paul, L
Powell of Bayswater, L
Ryder of Wensum, L
Walpole, L
Whitty, L

Witnesses: **Lord Carter of Barnes**, a Member of the House, Minister for Communications, Technology and Broadcasting, **Mr Roger Higginson**, Head of EU Post & Telecoms Policy, and **Mr Nigel Hickson**, Deputy Director, European and International ICT Policy, Department for Business, Enterprise and Regulatory Reform, examined.

Q1 Chairman: Lord Carter, thank you very much indeed for coming. Can you see the name plates for those around the table?

Lord Carter of Barnes: There is one of the noble Lords' nameplates that is obscured, but fortunately it is the one I know best!

Q2 Chairman: With your agreement, if we could allocate about forty or forty-five minutes – we apologise for starting slightly late. Perhaps you would care, for the record, to introduce yourself with your responsibilities, and your two colleagues.

Lord Carter of Barnes: Good afternoon. On my left, I am joined by Nigel Hickson, the Deputy Director, Europe and International; and Roger Higginson is Head of Europe and International Policy. I am the Minister for Telecommunications, Technology and

Broadcasting; so in theory, I am a converged minister – technologically at least! It is a great pleasure to be here today.

Q3 Chairman: Thank you for coming, and thank you to your officials. The first question is this: in our report, which I am delighted that you have brought, and a number of Members of this Committee sat on Sub-Committee B to produce that report - in our report on the original Roaming Regulation we concluded that the information base for the Regulation was incomplete and much of the evidence was circumstantial. What is the evidence base to support the extension of the Regulation to SMS, which, for the record, I think we can call text messaging, and data roaming?

Lord Carter of Barnes: I think the Committee was right, and indeed is right, to continue to programme the evidence base. My own view, and our view, is that there are two or three sources of further evidence, and then there is a reality of experience. The first and obvious source of evidence is the submissions that have come from the operators in the market, which, as you can imagine, given the introduction of wholesale regulation and indeed price caps, has been significant and substantial, which has had the good effect of increasing the amount of knowledge at the centre. Equally, whilst the ERG – and I speak as an ex-member of the ERG – never felt able to deal with this problem unilaterally, it has been a subject of ERG tracking and analysis on a country-by-country basis, and also in the key bilateral areas for some time. Both their initial submissions and their subsequent submissions have given us a significant evidence base. Then there have been the relevant country submissions. There is quite a significant body of evidence now, certainly in relation to voice, which is robust. I would argue that equally the same is true of texting. I think that data is, by definition, an emerging market, and therefore it would be fair to say that the evidence base on data is comparatively less robust, but then the proposals on regulatory intervention in the data market are less intrusive. Those two are probably not unconnected.

Mr Hickson: As the Minister said, the evidence presented by the European Regulators' Group has shown that as a result of the regulation introduced in June 2007, prices for both retail voice and wholesale voice have tended to cluster around the tariff caps that were introduced then. The European Regulators' Group hoped that the average price levels might show a degree of competition, and perhaps that has not emerged yet quite as we might have hoped.

Q4 Lord Powell of Bayswater: It is a question about the timing of this. Having an extension so soon after the thing has been adopted seems to be a bit curious especially as the explanatory memorandum says that the Regulation proceeded without major problems and achieved its principal objective. Is 18 months a bit short to have real, solid experience of how it has been working?

Lord Carter of Barnes: I think I share the questioner's scepticism about the driving rationale behind having an extension to the Regulation now. As I am sure colleagues are aware, this is a subject on the agenda for the Ministers' Council meeting next week. There are still some quite significant areas for probing discussion and debate. Having said that, clearly there is a political imperative here – let us be candid about it – that is driving some of the time. That is not all bad, because it has to be said that it was the political imperative that made this happen; and if we had not had that across Europe it would not have happened in the first place. The national regulatory authorities, in truth, were somewhere between impotent and indifferent on this question, probably for too long. Equally, as my colleague Nigel has just said, there has been some disappointment on the clustering effect on pricing, and this is designed to sharpen the pencil a little and to make people focus on a greater level of competition. I think there has been quite significant concern that the industry may be about to do to itself again, on data roaming, what it did on voice roaming; and therefore firing a warning shot now perhaps slightly earlier in the process, is no bad thing. It is a kind of a combination of all three of those.

Q5 Lord Powell of Bayswater: Has the industry given you a view on the timing? Has it made a big fuss about it or a modest fuss or no fuss?

Lord Carter of Barnes: What were the three fuss options? I have to say in the interests of accuracy that I have not yet had a detailed engagement with the mobile operators myself in this role. I have had engagement from two of the five here but not from all five. I am pretty well aware of their view, and my sense is that there is a mixture of – I am trying to get these in the right order of response - resentment, which is understandable resentment of anyone operating in what they feel is an aggressively competitive market of ex ante regulation; resignation that this is where we are, and it is going to happen; and a degree of relief that the actual price tables are not so aggressively close to or below costs that it is not operable.

Q6 Chairman: Can I just ask, following Lord Powell, whether the impending dissolution of the Commission - although some of the members might be reappointed - has been a factor in certainly one of the Commissioners wishing to focus on this?

Lord Carter of Barnes: I am not sure I know the answer to that. I suspect the answer is that I am sure it has.

Q7 Baroness Eccles of Moulton: Minister, the Committee, when discussing the question of a sunset clause, were very pleased when it was accepted – which meant the Regulation had a life. Now there is a proposal to extend it for three years. How would this make the Regulation more effective for voice roaming?

Lord Carter of Barnes: I think the hope is in two respects. One is because of the nature of the glide path over the period of time that it will allow industry and users to adjust over a sensible period of time, and hence extending both the period and therefore the sunset clause would make sense for that reason; and that therefore within that, because of the varying degrees of development of different markets in Europe, and within that the varying degree of

efficiency of different operators within Europe, we will get to a point whereby real competition will be able to play out, because there will be a much more sensible average operating cost that everyone will be able to work with. I think that is the argument.

Q8 Baroness Eccles of Moulton: You would be hopeful that by 2013 the sunset clause could operate!

Lord Carter of Barnes: I definitely would be hopeful. I have to say I do have some form on this question. I was extremely disappointed that we had to end up here in the first place. The UK has, it is fair to say, probably the most competitive mobile market in Europe, not just in the network operators, but also the virtual network operators – if you take the combination of the network operators and the virtual network operators, we have an attractively competitive market here if you are a user of mobile services. Equally, it is unarguable that the operators were extracting unjustifiably high prices and that they had been given a lot of warning that this was an issue; and so it was an inevitability therefore that we were going to end up with Regulation. I think part of the reason why the Regulation was quite as intrusive as it was, and the reason why there is quite the same degree of political enthusiasm to come at this question again and extend the sunset clause, is because of that initial reluctance to participate constructively. However, the analysis will tell you that if we get to 2013 and we end up with lower termination rates, then that will have the effect of naturally lowering prices, and therefore the sunset clause should be able to operate.

Q9 Baroness Eccles of Moulton: The hope is that the industry would not react, if the sunset clause operated, by going back to their old ways!

Lord Carter of Barnes: If you have got to the point whereby termination rates are at that level, then it should not happen. That is the theory – that is the theory!

Q10 Lord Haskel: We have already touched on this matter of the prices clustering around the wholesale and the retail caps, but of course this is something that the Committee was very concerned about, and we thought it was likely to happen. We thought that there should be an average instead of an absolute price cap; but as it has now happened, could you say why has the retail price cap for voice roaming been maintained, and should not consideration be given to replace the absolute cap with an average one, so that we get a bit more competition into the market?

Lord Carter of Barnes: I am afraid I do not know – I factually do not know - and perhaps Nigel or Roger can help me here - how much consideration was actually given this time around to re-visiting the question of absolutes versus averages. I suspect, in truth, it was probably not a lot! I do not know if I am wrong in that. Why is that? I think there is a pragmatic reason for it and a political (with lower case “p”) reason for it. The pragmatic reason is that these absolute numbers are easier for everyone to understand – for consumers to understand – and they are easier for industry to work with, particularly when you are dealing with sole operators, inter-party operators and network-sharing arrangements. For that reason, pragmatism prevails. The political reason (with lower case “p”) is that if you go for averages, then some people end up paying more than they do with absolutes. I suspect that is the reason. Am I incorrect or am I missing something?

Mr Hickson: No, Minister, you are not incorrect. I think there is just one other point. The Minister is right; it has not been discussed in any detail this time around, Lord Haskel, but it was discussed when the Roaming Regulation was first brought forward. One of the real difficulties in addition to measuring an average cap by the national regulatory authorities is that if you put an average forward, then the tendency would be for prices to vary around that average, but always to meet that average. In effect, you would be imposing a retail regulation whereas what we did last time around in setting a cap was to set a cap in the belief that the

economic competition in the market would serve to hit a target below that cap; and so would deliver better for consumers.

Q11 Lord Haskel: The explanatory memorandum in paragraph 11 says: “The Commission concluded that there was ‘a significant risk that allowing the regulations to expire would lead to an increase in prices’”, and that is why it remains as it is. I was not quite sure why that followed. It is in paragraph 11 of the explanatory memorandum, where they talk about the wholesale and retail prices remaining clustered around the levels of the caps.

Lord Carter of Barnes: I do not have the detailed copy, for which I apologise, but I suspect, again, that part of it is the reason that Nigel has just outlined. What you have not seen, if you like, is independent pricing, or pricing behaviour independent of the pricing caps; and therefore if you remove the pricing caps what happens is that people revert to type - and that that type has not been sufficiently institutionalised, particularly as it relates to termination rates; and until you get to that point then you should not feel comfortable enough to remove the guide of the maximum retail price cap. I have to say I am sceptical on this; but, equally, I have to confess that I was sceptical about it, but there is no doubt that if it had only been wholesale price caps, I do not think we would have seen the prices coming down to where they are. You have to ask yourself a question: what price has been paid because a price has clearly been paid somewhere - this is not free money. I have certainly been asking my officials to try and give me some more evidence around this before I go to the Council meeting next week, because this has had the effect of taking revenue out of the market. If you look at the increase in the absolute volume of roaming minutes, it does not seem to be as large as the reduction in price, so that cost is being borne somewhere. Wearing a parochial British hat, which is largely my job, that, I think, is particularly acute in the UK market where returns on capital for the operators, certainly for the network operators in the UK, are not what they once were; and that does force people to make decisions about where they spend their capital:

do they spend it in the United Kingdom or do they spend it in other parts of the world? There is a connectivity here; but having said all that, the prices I am pretty sure would not have ended up where they ended up, had we not had that capping mechanism.

Q12 Chairman: Has there been any evidence from industry that indicates that companies have been seeking to recoup from domestic mobile phone services some of their losses due to the capping at retail level? Is there any evidence of that?

Lord Carter of Barnes: I think there has been more argument of it than evidence of it. I think there has been some evidence on domestic pre-pay tariffs of an increase, and, again, logic would tell you that we will probably see more of that because we are now over-penetrated in this market, so people cannot compensate through growth, certainly growth driven by penetration and compensated growth through additional usage. Actually we have continued to see some quite significant innovations in the UK market on minute packages, roaming packages and alternative packages - so not yet. I think that if there is a waterbed effect - and, as I say, I do not know the answer to this yet, Chairman - my start point is that it is probably less invisible at the point of the market where the consumer uses the service and more visible at the capital end of the market. These are very capital-intensive businesses, and they are very capital-intensive businesses beginning to go through a technology change. I think if we should have a concern for us to look at very carefully, that is where our concern should be.

Q13 Lord Paul: During our inquiry, concern was expressed by some witnesses that the price caps would stifle innovation. Has this proved to be the case?

Lord Carter of Barnes: No, I do not think that has proven to be the case. As I say, that is largely because we have a greater number of players in the UK market. I do not know whether or not there is evidence around Europe, and certainly in those European markets that have a lower number of virtual network operators than we do and a lower number of fixed

operators than we do; but we have seen a range of tariffs on bundling of roaming voice minutes, roaming voice calls at the same price as domestic calls on partner networks; we have seen the use of domestic post-pay call allowance for roaming calls on partner networks - a swapping of credits; and we have seen monthly subscriptions on discounted rates, or reduced rates, back to the United Kingdom. The operators have innovated. The operators' argument always was: "We were just about to do that anyway" or, "We are doing that anyway". The truth of course was that they were doing a bit of it but not as much as you might have wanted and not with as much focus or enthusiasm as you might have wanted. It would appear at the moment that there has not been. As I said earlier, Lord Paul, I have a nagging concern in the back of my mind, which I have expressed before to the Commission, that we must not view this industry as a free take; there is a price to be paid. Mobile technology and wireless technology is going to become an ever more increasing part of both domestic access to new services and industrial access to new services, and I think we would look back in five or ten years and kick ourselves if, in order to take what appears to be a "no price win" on one service, we end up paying a significant price on future development in other areas. That is the axis that we need to keep an eye on.

Q14 Lord Walpole: Minister, the data roaming proposals include a suggestion that a warning and cut-off facility should be provided to customers. Is this technically possible for all mobile technologies including mobile phones and laptops?

Lord Carter of Barnes: Not yet, I think is the answer to that, but we are reasonably reliably informed that it will be and should be by 2010. If this becomes effective, it would be effective by 2009, so there would then be a sunset clause on the bill shock implementation mechanism, on the transparency mechanisms by 2010, but this is definitely an area where we think there is a bit of work to be done on the Commission's proposals and on the detail of the text, and it is one of the line items in my brief to myself.

Lord Walpole: I think we rather expect this, and if you can take it to Europe when you are there, I am sure we would be very grateful, would we not, Chairman? I have a mobile phone! It does not work though, and I do not live more than a hundred miles from London, and it never will work there, I do not think, unless I change to a different company.

Lord Ryder of Wensum: Stick to the pigeons!

Q15 Lord Walpole: That is a far better idea. Certainly the laptop thing interests me personally because we do a lot of communication, as a business, by laptop - in fact more and more - and I am surprised that the postman still turns up. He does occasionally!

Lord Carter of Barnes: Not as often as he would like - but that is another story!

Q16 Lord Walpole: Absolutely! Mobiles phones are things that irritate me because they do not work when you want them to. I hope they will.

Lord Carter of Barnes: I certainly share your enthusiasm for data and laptop, wireless, broadband deployment. As I said in response to an earlier question, it is very - this mechanism - if it is got right - could be a very, very sensible piece of self-disciplining positive regulation that avoids the need to end up with more aggressive intrusive regulation in another sphere later on.

Q17 Lord Whitty: Unless Norfolk is seen as a special case, I should say that neither mobile phones nor broadband work that well in Dorset either! However, I was going on a different tack although it is similar territory, and I should declare an interest as the Chair of Consumer Focus that has pointed out some of the problems of differential access to broadband or differential price or quality of broadband. In that context, does the Government have a view on whether it would be desirable for broadband to be included in a universal service directive?

Lord Carter of Barnes: The Government does not have a view yet. I think the Government is forming its view. The noble Lord may be aware that one of the key parts of my job/appointment is to commission, produce and, to a degree, write a framework report on the sector, so-called *Digital Britain Report*, which we are seeking to publish an interim statement on at the end of January and then a definitive statement by May or June; but the purpose of the report or the analysis will be multiple but within it and central to it will be the question of how we should look at the universal service obligation in the round, and then either how it should be maintained or, if it is extended, extended to what; and then, if it is extended, how that will be funded and executed. This is a very live issue in Europe. To my understanding, the only countries in Europe that have expressed a definitive view on it so far are France and Finland, which have taken a slightly more unilateral “here is what we think we should do” - and there is a real opportunity here. Going back to the noble Lord’s comment about the increasing importance of wireless and mobiles and means of delivering broadband, I think we are well past the point whereby we need to think about universal service as more than a copper wire if we genuinely have a desire to get equivalence and reach. It may be scant comfort in Dorset but it is worth saying that in this country we are actually quite richly served by network density, which is not true of all of our European partner nations by some margin, and certainly not true internationally. The question is: how do we knit together patchwork technologies in order to get true universality? In order to do that we have to get to a point of inter-operability between fixed networks and mobile wireless networks. To get to a point of inter-operability between the fixed and mobile wireless networks there are many things you have to resolve, but one of the key things is that the interconnect pricing regimes in those two networks are very, very different. There are some quite complex economics as well as some quite big policy issues.

Q18 Lord Haskel: Minister, following on from what you have said, I thought you would also include, when you talked about broadband, things like Skype. Of course, there you can see the person as well as talk to them, and I just wondered what kind of impact you thought that would have on this universal service directive.

Lord Carter of Barnes: If I understand the question correctly, at the moment the universal service obligation, from memory, is that there is an obligation to provide a telephone connection and functional Internet access. Technically, functional Internet access can allow some for of video - pretty slow and pretty croaky, but it can allow it. One of the questions in the universal service debate going forward is: what is the future definition? The difficulty is that lots of people start in different places. There are the pigeon fanciers who are in one place, and then there are the people who are sitting on 20 megabit connections who are in another. Universal service obligations, by their very nature, have got to find an affordable common point; so I suspect there will be some limits on video capability, but considerably more, one would hope, than what is currently do-able.

Q19 Lord Whitty: If I can just intervene, we have the Minister here - and as an incoming Minister he is probably uniquely qualified in his knowledge of the regulatory framework over which he now has oversight. I wondered if, since you have gone from being a regulator, you felt that regulation both at the EU and the UK level had moved in the right direction and faster or slower than you would have anticipated a few years ago?

Lord Carter of Barnes: In mobile specifically?

Q20 Lord Whitty: I was thinking of mobile specifically, but if you would say broadly that would be interesting.

Lord Carter of Barnes: The mobile industry has definitely moved into the full crosshairs of regulation. That has got to be worrisome. It may be producing beneficial outcomes in the

reduction of prices, but if you believe that ultimately markets are the most efficient price-setters - and in truth they should be - then having to have detailed retail and wholesale price caps on a function-by-function basis feels very clunky. To draw an analogy, the telecommunications regulatory community across Europe has spent twenty years trying to get out of that in fixed line regulation. It does not feel like a triumph to have leapt out of retail price controls in fixed line regulation, only to leap into retail price controls in mobile: it seems an odd form of regulatory groundhog day, but that is where we have ended up. In my view, the most significant responsibility for that frankly lies with the industry. The temptation to be avoided by the political classes and the regulatory classes is not just to drive remorselessly ahead with that, but it is to try to find a balance of intervention that can be exited and can provide the necessary avoidance of future mistakes in other new and emerging markets, like data for example. More broadly, it is still the case, largely because broadcasting is a reserved power, that European-wide regulation of communications is not as converged as you would want it to be; it is still the case that we have discussions about audio/visual, about fixed line, about mobile, about content and about standards. They are quite slow discussions, whereas I think most of us know increasing consumer behaviour is that these things are all converging at a far, far more rapid rate than our own domestic structures, let alone than the European structures.

Q21 Chairman: We are almost at the end of the session. I wondered if I could ask a question about supply of information to you, not only from industry but academic sources and business associations, as to what is really going on and what is likely to happen in terms of competition, innovation and capital investment. To a certain extent one gets the impression - and this is a personal view - that the Commission is flying a bit blind and taking a natural reactive step, which is to control prices without really understanding where we might and should be in five or ten years' time in terms of encouraging a free market, an innovative

market and one that is continually investing. Therefore, my question is: what flow of intelligence does the Department have?

Lord Carter of Barnes: In this instance it is the Department for Business largely. I am quite happy to unashamedly defend my Department here. I think over the years the Department has been well informed on these matters and has been a significant contributor to what you might call the after-the-fact fashioning of what is actually going to happen to solve a problem that has been identified. Going forward there will be a new commission, and as ever there will be new faces and new spaces. I think there is an opportunity for all governments - and we will certainly seize this - and I would say also for the industry to engage. Partly because the mobile industry has found itself in the centre stage of regulation, an awful lot more academic work has been done on this of late. My understanding is that there is going to be a European invitation for academic discussion and debate and for contributions to be made; so I think there will be a reasonably fulsome opportunity there.

Mr Hickson: I think that is absolutely correct. Lord Freeman, you have rightly said that the pace of these discussions has perhaps somewhat limited the amount of debate in the Council. As the Minister said, the subject is on the table next week for general approach. The European Parliament is yet to have its first reading. They have scheduled fairly widespread hearings to understand exactly the economic case for data regulation and for price controls on text messages, so there is going to be a wider debate. Here, as you know, we have initiated a public consultation, and hopefully we will be getting evidence from that which will enable us to be in a better position to understand some of the economic arguments. As the Minister alluded to, and Lord Walpole mentioned, we are working very closely with the Commission and other Member States to achieve a more sensible approach to bill shock in terms of consumers being able to know when they have used a certain amount of their tariff.

Mr Higginson: It is my understanding that the European Regulators' Group, which has already produced one study on the mobile roaming market is due to publish a more comprehensive one I believe by Christmas at the end of this calendar year; so that will once again serve to reinforce the evidence base.

Q22 Chairman: Thank you very much for coming. I understand that next week it will be a general discussion. We will certainly follow the process of further regulations. We are interested in the subject and want to be supportive and helpful; but we also want to elucidate from Government, from your own Department, some of the facts and indeed policy decisions. Thank you very much indeed for coming. Could I ask my colleagues formally - we have to go through the process of voting to lift scrutiny or not lift scrutiny, and we cannot do that in front of the Minister!

Lord Carter of Barnes: I would not want to try and influence your vote in any way, shape or form, but can I make one observation? Unless I am mistaken, I do not believe there is a similar such level of scrutiny on this question in the Commons. Am I correct? From my observation, this is an extremely worthwhile scrutiny process because this is a very real issue. Being put under scrutiny is valuable; the fact of being put under scrutiny is particularly valuable; and I would encourage as much of it as the Committee is interested to do, because this will become more complex over the next year or so.

Chairman: We look at the quality of the beef going into the grinder; they eat the sausages!