Wholesale mobile voice call termination – preliminary consultation
Response from O2 (UK) Ltd

O2 (UK) Ltd ("O2") welcomes the opportunity to respond to Ofcom's preliminary consultation on mobile voice call termination[1].

Our response to this consultation should be read in conjunction with our response to the proposal to modify the wholesale mobile voice call termination charge controls in order to extend them beyond April 2006.

Our response to the questions posed in the consultation is set out in the attached Annex. The remainder of this document sets out our principal concerns.

Prospects for the underlying cause of SMP to be eroded

There is no doubt that mobile is an extremely high growth and innovative industry. New services are being developed and launched continuously.

O2 believes that it is quite conceivable that services may be launched in the next few years that may increase further the competitive constraints on the provision of wholesale mobile voice call termination services. Services with an element of receiving party pays ("RPP") have been in operation, successfully, elsewhere in Europe. Services based on internet protocol, such as push-to-talk, also employ an element of RPP.

While it is difficult to conclude at the moment that such services will succeed and that they will increase the competitive pressure on wholesale mobile voice call termination services, Ofcom must keep the matter under constant review and, if additional competition is injected into the market, should dismantle the regulatory framework at the earliest opportunity. Similarly, Ofcom must ensure that any remedies it does seek to impose would not have the effect of preventing or restricting the extent to which new services can be developed and launched.

Distorting effects of asymmetric regulation

In the consultation, Ofcom highlighted some of the consequences of perpetuating the current regulatory regime whereby voice call termination on 2G networks is regulated, but the same service provided by 3G networks is not.

O2 agrees with Ofcom's analysis that this may lead to a situation where regulation of voice call termination is effectively bypassed, as operators seek to terminate more calls on 3G networks at relatively high nominal charges. Indeed, the incentive to do so might be thought to be high in circumstances where one operator, '3', sets charges for voice call termination that are approximately twice that of the other mobile operators, as is the case at the moment.

Ofcom is correct to highlight the prospect that asymmetric regulation could create artificial incentives for MNOs to use one technology over another. This would clearly

[1] Wholesale mobile voice call termination - a preliminary consultation on future regulation. Ofcom, 7 June 2005

be inconsistent with the European regulatory principle of technological neutrality. In O2's view, the perpetuation of the current regime may well result in this outcome.

However, in addition to this, allowing '3' to benefit from inflated voice call termination charges also distorts the mobile access and call origination market as a result of the "waterbed" effect. '3' is able to use the large revenues it accrues from providing voice call termination services, to subsidise customer acquisition (by subsidising handsets and paying commissions to dealers) and offering cheaper call tariffs[2]. Mobile operators required to charge less than their rivals for identical wholesale voice call termination services are unable to fund their activities in this way. Accordingly, there is a distorting effect in the "outgoing" market, attributable to asymmetric regulation of voice call termination services. But the cause of the asymmetry here is more than the absence of charge controls on 3G networks, and includes the difference in permitted charges levied by 900/1800 MHz operators and 1800 MHz operators.

Approach to the regulation of voice call termination services in the medium term

For the reasons stated above, O2 believes that Ofcom needs to address the issue of voice call termination on 3G networks. Indeed, you will see that in our response to the charge control consultation, we believe that this should be done now.

Historically, Ofcom has chosen to undertake a "bottom up" empirical analysis, in setting charge controls. In the case of wholesale mobile voice call termination on 2G networks, Ofcom held this to be possible because:

- the market was relatively evenly split between four MNOs, which had ultimately constructed networks with similar geographic coverage – allowing the development of an "average operator" cost base;
- The model could use a number of years of data about market growth and costs;
- The asset base was being used in large part for voice services alone so it did not present the cost allocation problems we see with 3G LRIC, (notwithstanding the process of developing the 2G model to wrestle with SMS and the growth of pre-pay); and
- All operators paid similar spectrum fees, meaning that there were not enormous disparities in the costs incurred by those operators in setting up their networks to deliver a wide range of services, including wholesale mobile voice call termination.

Ofcom is not presented with such circumstances in relation to 3G. We appreciate that Ofcom's consultants have begun the task of constructing a new LRIC cost model, to address the issue of 3G. However, we consider that it is highly likely that the resulting model will deliver a large range of values for the cost of terminating voice calls on 3G and 2G/3G networks, simply because a number of key variables

[2] 1800 MHz operators are able to fund their activities in the access and call origination market in a similar way, through higher termination charges, relative to 900/1800 MHz operators. Ofcom will note from our response to the proposal to amend the charge controls that O2 believes that the distinction in termination rates between 900/1800 MHz operators and 1800 MHz operators is not justified.

are just not known at the moment. In these circumstances, we believe that it is very unlikely that Ofcom will be able to rely on the results of the LRIC cost model to determine a value for the cost of terminating a voice call on a 3G network.

Furthermore, in O2's view, it is likely that these variables will remain unknown for a number of years, with the consequence that any model developed is unlikely to yield a reliable figure for the cost of terminating a voice call on a 3G network. In light of the transient distortions in MNO cost bases that might arise from technological changes (e.g. 2G to 3G migration and refarming) between now and 2010, we feel it wise that Ofcom should not revisit an empirical analysis for 3G until the 2010 timeframe.

While empirical models are one way of setting a price control remedy, there are other options available to Ofcom. The ERG Common Position on the approach to appropriate remedies in the new regulatory framework[3] states that:

> *"The freedom of the NRA to use a methodology or a particular cost model to calculate an appropriate charge is unrestricted except to comply with Article 8, general competition law and the requirement that it serves to promote efficiency, sustainable competition and maximise consumer benefits"*[4]

We understand that Ofcom is required to determine whether LRIC is an appropriate methodology in the circumstances. However, if its preliminary analysis in the autumn shows that LRIC is not the most appropriate approach, it is clear that Ofcom has the ability to determine some other method for imposing a charge control on 3G voice call termination. An inability to derive a LRIC for voice call termination on 3G does not mean that Ofcom is somehow unable to determine an appropriate charge. It merely has to determine the next best alternative mechanism for determining such a charge.

The use of benchmarking as an appropriate method for setting charge controls for voice call termination

You will see from our response to the consultation on the modification to the charge controls, that we are advocating an adjustment to the 2G LRIC model to remove the cost distinction between 900/1800 MHz operators and 1800MHz operators.

O2 believes that, in the absence of robust LRIC estimates to determine 3G costs, a common 2G stand alone LRIC, plus mark ups for common costs, externalities and migration costs to 3G, should be used as a benchmark.

There are very good reasons for the use of 2G LRIC as a benchmark for setting charge controls on 3G voice call termination services:

- 2G is the predominant technology that is used to provide wholesale mobile voice call termination services, and will almost certainly be so for the next few years;

[3] http://www.erg.eu.int/doc/whatsnew/erg_0330rev1_remedies_common_position.pdf
[4] page 53

- Ofcom's 2G LRIC model is well established and understood;
- Voice call termination services are homogenous – those provided on 3G networks are the same as those provided on 2G networks;
- If the LRIC for terminating voice calls using the potentially more efficient 3G technology is less than that for 2G networks, 3G MNOs would benefit from benchmarking. If the opposite were true, it is not clear that callers to mobiles should pay more for a service that can be provided more cheaply on a 2G network[5];
- It is technologically neutral and therefore minimises the risk that regulation generates artificial investment incentives.

In these circumstance, O2 believes that using 2G LRIC as the benchmark for determining the charge control for voice call termination on 3G networks, making suitable amendments for capital/operating cost adjustments, common costs and externalities, represents the most appropriate way forward on this issue (should Ofcom decide to implement charge controls at all).

In addition, there should be an allowance for costs associated by a migration to 3G (which provides for a greater range of services, potentially at greater efficiency), in the same way that Ofcom is proposing to permit BT to include costs associated with migration to 21CN in the charges it levies for regulated products.

O2 would not expect such a common wholesale mobile voice call termination rate to be any less (in real terms) than O2's present charge control, of 5.63ppm.

O2 understands that NRAs across Europe have already benchmarked 3G to 2G prices. Ofcom should not feel constrained in applying the benchmark to any operator of a 3G network, in the absence of robust 3G LRIC figures. Indeed, the ERG Common Position on the approach to appropriate remedies in the new regulatory framework notes that:

> "The burden of proof to demonstrate that charges are derived from costs including a reasonable rate of return on investment rests with the operator"[6]

In the absence of robust results from a 3G LRIC analysis, this would seem to give Ofcom considerable discretion in applying a common charge control to all providers of wholesale voice call termination services.

Other benefits of the benchmarking approach

The application of benchmarking to all players in the mobile market, irrespective of technology or status of a new entrant with *"limited….subscriber base"*, means that all new and existing providers of voice call termination services are provided with certainty as to the level of return they will make from offering such a service.

[5] furthermore, this must call into question claims by such operators that they are somehow benefiting form a "lower cost technology" to deliver cheap calls in the access and call origination market. If this were true, then it is not at all clear why they can then levy higher charges for voice call termination.
[6] page 53

This is particularly important in the period 2006-2010, when Ofcom is considering auctioning further spectrum for mobile services. If Ofcom perpetuated the current situation, investors in new spectrum would be left with a highly distorted set of bidding incentives at any forthcoming spectrum auctions.

If some bidders have an expectation that their voice call termination rates will be capped to that of their existing services, but new entrants or 3G only operators do not, then:

- 2G/3G MNOs will know what price to factor into their revenue calculations when determining their bidding strategy in any spectrum auction
- 3G only and new entrants will either be able to set a price to suit the value of their bid or, in extremis, have the knowledge that they would be able to recover a proportion of any increment they might wish to overbid the 2G/3G MNOs through LRIC based charge control.

If all current and future providers of homogenous mobile voice call termination services are required to offer a blended rate at no more than a prudently determined "2G only" rate, then all investors will understand the potential future value from the regulated revenue accruable on the spectrum they are purchasing.
This would benefit citizen-consumers by removing a reliance on them to fund innovation in other mobile services through the delivery of voice call termination services. It would benefit investors in mobile companies by ensuring that they can determine accurately the valuation to be placed on voice call termination revenues in the business plans presented to them.

Importantly, a common wholesale mobile voice call termination rate may also enable BT (and other fixed operators) to offer a standard retail rate for fixed to mobile calls, regardless of the mobile network called (subject to mobile operators' ability to determine independently peak, off-peak and weekend rates). At the very least, it would enable a fixed operator to offer similar prices for calls to different mobile networks. This would clearly benefit consumers, helping them better to understand the retail prices of such calls. This in turn could also increase the price sensitivity of consumers, increasing further the competitive pressure on wholesale mobile voice call termination services.

Annex

Question 1 Could RPP principles be made to work to the advantage of consumers in the UK? If so, how?

O2 believes that a move to pure RPP arrangements in the UK is neither practical nor desirable, for the reasons stated in the consultation document.

Nevertheless, there are mobile services available in other parts of Europe which include elements of RPP and which, O2 submits, provide a competitive constraint on wholesale voice call termination pricing. In our response to the consultation on the charge control modification, we explained how the Genion service provided by O2 Germany allows calling customers the choice to contact mobile customers by using either a geographic number (at a relatively lower retail rate), or a mobile number (at a standard mobile rate). Where the calling party elects to use the geographic number, and the called party is outside their "home zone", then the called party can choose to receive the call by paying a RPP element. Thus the cost of the call is shared.

O2 believes that a service like Genion does provide a competitive constraint to wholesale voice call termination. If a mobile operator seeks to increase the price of wholesale voice call termination, this is filtered through into higher originating retail rates. Consumers would be more likely to make calls using the geographic number.

[✂…]

In the medium term, the effects of the introduction of Internet Protocol (IP) services into the mobile domain are unknown. It is unclear the extent to which services such as Skype may be deployed over mobile networks. This would by default introduce a form of RPP. Even if such IP based services do not become widely used, they would act as a competitive constraint on traditional call termination methods.

In conclusion, when considering the issue of whether RPP is likely to be seen in the UK, Ofcom should consider not simply pure RPP, but also services where there are elements of RPP and which also constrain wholesale mobile voice call termination.

Question 2 Is it realistic to believe that a competitive market for wholesale termination of voice calls could be made to operate successfully. How might such arrangements work?

O2 believes that a market, as envisaged by Ofcom, is unlikely to be practicable.

Question 3 Is VoIP likely to have a significant impact on the market for mobile voice call termination during the period to 2010? What are the possible obstacles to this outcome and how might industry or Ofcom overcome these?

O2 believes that, in principle, VoIP services would add additional competitive constraints to wholesale mobile voice call termination services.

However, while various IP based services, like "push to talk" are being launched, it is too early to predict the impact on the provision of wholesale mobile voice call termination services.

In O2's view all voice services should be subject to the same regulatory regime. This means that Voice over IP Services ought to comply with the regulatory regime that governs the provision of electronic communication services, that is the General Conditions of Entitlement and, indeed, the other potential conditions set out in the Communications Act 2003. Anything other than a "level playing field" approach would be contrary to the principle of technological neutrality, enshrined in European legislation.

O2 believes that Ofcom should keep the position under review with a view to withdrawing from regulation promptly should the conditions render that appropriate.

Question 4 Are there other options, not considered elsewhere in this consultation document, for removing the underlying causes of SMP?

As we have set out in our response to the proposals to amend the charge controls, O2 believes that Ofcom has made errors in its analysis of the relevant market and has underplayed the competitive constraints on wholesale mobile voice call termination.

That aside, O2 is not aware of other options, not featured in the consultation document, for increasing further the competitive constraints on wholesale mobile voice call termination services.

Question 5 Do you believe, on balance, that a retail-minus approach to setting wholesale prices would be advantageous?

Ofcom has highlighted the difficulties of determining the appropriate retail basket with which to determine the wholesale voice call termination rate. However, this is further complicated by virtue of there being no "undistorted" starting condition.

Ofcom's current policy of asymmetric price control has allowed some operators to place a significant discount on their retail call origination prices through the waterbed effect, as a consequence of the absence of a price control on their voice call termination rate, or through a preferential regulated termination rate.

Clearly, it would be discriminatory to regulate wholesale voice call termination rates on the basis of such distorted retail prices.

However, there may be merit in considering another option. Retail prices for outgoing calls will continue to decline through competitive pressures. Once all mobile operators are on the same starting point with their respective termination prices, reductions in retail prices could be used as an indexation for reductions in individual termination prices. This might leverage the competitive pressures on outgoing prices into incoming.

Question 6 Do you agree that asymmetric regulation of voice call termination, which is applied only to termination on 2G networks, will cease to be effective as the proportion of calls terminated on 3G networks grows?

O2 believes that, under the current asymmetric regulatory regime, it is quite conceivable that 2G operators will seek to increase their "blended" termination rate by assigning a higher termination rate to calls terminated on 3G networks.

Indeed, the fact that '3's termination rate is approximately twice that of the 2G operators provides a clear incentive on the 2G operators to use '3's rate as a nominal rate for voice call termination on their respective 3G networks and, in so doing, establish a higher blended rate.

[✂...]

Question 7 Do you believe that asymmetric regulation of mobile voice call termination, which applies only to termination on 2G networks, will create material incentives to terminate calls on 3G networks. If so, how easily could MNOs develop the technology necessary to follow these incentives?

If Ofcom imposes asymmetric price control of termination on 2G and 3G networks, or fails to regulate call termination on 3G networks altogether, operators will have a significant financial incentive to maximise the number of calls terminated on their 3G networks. Clearly, any operator which does not do this, or which keeps 3G termination rates pegged to 2G rates will be disadvantaged compared to its competitors. In particular, unlike its competitors, it will not be able to re-invest higher earnings from 3G call termination into the origination market. Given the highly competitive nature of the access and call origination market in the UK, this would put it at a significant competitive disadvantage.

The only response to such pressure is for an MNO to increase the volumes of calls terminated on its 3G network, in order for its revenues to keep pace with its costs of terminating calls on other 3G MNOs' networks. If '3' is allowed to retain its unwarranted termination rate, or other MNOs begin to take advantage of unregulated 3G rates, O2 believes that the market will soon degenerate into a termination rate "arms race".

Increasing an MNO's "blended" rate may be practically achieved in a number of ways:

(a) Build further network coverage for 3G, beyond that currently required for commercial non-voice 3G services; purely to increase the volume of voice calls terminated on the operator's 3G network.

(b) Subsidise 3G handsets at a premium to 2G handsets, in order to enable more customers to terminate voice calls on 3G networks

[✂ ...]

Asymmetric price control may distort longer term investment incentives and have a causal impact on the final state of the mobile voice and data market. For example:

- it may become more cost effective to fill up the 3G network with voice calls than data, because of the price premium allowed by the regulator – Ofcom's price control decision for 3G (or its absence) effectively creates a "hurdle rate" for other 3G traffic to utilise the network
- such a position may result in distorted investment decisions - MNOs may be forced to invest in more 3G cells than they would otherwise do. Clearly such an artificially created demand for mast sites does not sit comfortably with the broader Government agenda of reducing the environmental impact of masts, through site sharing etc.

Question 8 Would it be reasonable to require that charges for mobile voice call termination (2G or 3G) are no higher than the cost based charge for the more efficient form of termination? What are the risks and advantages of this approach? If that course of action was adopted, how should that be applied to an MNO with no 2G network of its own?

Although 3G has enabled mobile operators to introduce a range of new innovative services, such as video messaging, surfing the internet at high speed, watching television clips and receiving sports flashes, voice call termination itself is not a new or innovative service. Indeed, the European Commission reminded Ofcom in relation to its previous decision that *"although 3G retail service might constitute a newly emergent market, which should not be subject to inappropriate obligations, termination of voice calls on 3G networks is not as such to be considered a novel service or a newly emergent market"*[1]. The fact that it might be delivered over 3G technology rather than 2G should make no difference to regulation. O2 welcomes Ofcom's apparent acceptance of this point.

As rational investors, 3G operators will have purchased their spectrum and built their networks with an eye primarily to the potential for services that are not replicable on 2G networks, but also to the potential for cheaper unit costs in the long run. It would appear that O2 and (perhaps) Ofcom are not alone in this assessment of 3G operators as rational investors. At '3's recent Competition Appeals Tribunal appeal on its current SMP designation, Professor Stoneman commented from the Bench:

> "*If the 3G product has a long run average cost that is greater than the long run average cost of a 2G product, then in a free market with free entry the 3G product will be driven out of the market unless the 3G product is considerably superior to the 2G product. We are always talking about voice call termination and nobody has said that voice call termination on a 3G network is better quality or more prompt, or whatever, relative to a 2G network?"*

He continued, *"they* [the MNOs] *would not be moving from 2G to 3G if 3G were more expensive"*

Mr. Green QC acting for H3G went onto suggest that the cost of the 3G platform may be higher than 2G because it is required to support *"a whole range of interactive and additional services".* Professor Stoneman concluded *"That does not mean it* [the cost] *should be carried by the wholesale voice call termination price."*

The investment risk that attaches to 3G results from the uncertainty of demand for new (data) services, not established voice services, whether outgoing or incoming. Indeed, this distinction is recognised by the European Commission by defining the services susceptible to *ex ante* regulation as being voice call termination on individual mobile networks.

The advantage of 3G for mobile operators is that it may allow economies of scope in that voice call termination will be provided along with many other services not feasible with 2G technology. It has been suggested that such economies would lower the cost that might be attributed to voice call termination, as this will now be jointly supplied with other services. However, in the absence of a full analysis of the cost of providing voice call termination on 3G networks, this is not known.

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[1] Comments pursuant to Article 7(3) of Directive 2002/21/EC in response to case UK/2003/0040. However, in June 2004, Ofcom chose to set aside this advice.

Consequently, as we have highlighted elsewhere in this response, the lack of reliable 3G LRIC numbers would not prohibit Ofcom from undertaking appropriate price control for 3G and 2G/3G networks. Although empirical purists may see spreadsheet models as the last word in cost-orientation (noting that it is the absence of firm empirical data that is the key problem with the proposed 3G cost modelling), the next best alternative must be the selection of an appropriate benchmark. Indeed, the ERG Common Position on the approach to appropriate remedies in the new regulatory framework[2] states that

> *"The freedom of the NRA to use a methodology or a particular cost model to calculate an appropriate charge is unrestricted except to comply with Article 8, general competition law and the requirement that it serves to promote efficiency, sustainable competition and maximise consumer benefits"*[3]

Without benchmarking, Ofcom notes that it would be a perverse outcome if regulation incentised investors to benefit from providing an identical service based on new technology (3G, in this case) at a cost greater than that of an identical service supplied by the use of an existing technology (2G), and to be rewarded for doing so by charging consumers more.

It is also the case that when 3G licences were acquired, cost-based regulation of call termination was in place following the MMC enquiry in 1998, and thus the licences were bought on that basis. A reasonable assumption would have been that this form of regulation would continue to be applied on the specific service of voice call termination. This must be the case, in particular, for Hutchison which presently owns '3' since, at the time of the MMC enquiry, it owned Orange, which operated its 2G network at the time.

Permitting 2G rates for 3G voice call termination (if 2G voice call termination is regulated) provides all mobile operators with a fair settlement as they will benefit from economies of scope while, appropriately, they are not regulated on any of the new services for which they acquired 3G licences.

O2 believes that it is therefore proportionate for the same regulation to apply to both 2G and 3G call termination services. If 2G voice call termination is regulated, unless there is regulation of 3G voice termination services, Ofcom is right to be concerned that there may be distortions in investment (in favour of 3G) and an increase in retail call charges to call mobile phones (as more calls are terminated on unregulated 3G networks).

In addition, because of the existence of the waterbed effect, unearned termination revenues accrued in terminating calls on 3G networks will be ploughed into the outgoing market, increasing handset subsidies and reducing mobile retail rates. To the extent that mobile operators' revenues from terminating calls on 3G networks will be different, this is likely to distort the mobile outgoing market whilst asymmetric regulation remains.

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[2] http://www.erg.eu.int/doc/whatsnew/erg_0330rev1_remedies_common_position.pdf

[3] page 53

Question 9 On what basis could a single charge control, to apply to both 2G and 3G voice call termination, be calculated?

As we highlight in our answer to question 8, the benchmarking of 3G to an appropriate 2G rate applies just as much to a 3G only new entrant, as it does to 2G/3G operators. Indeed, it may be that the "green field" new entrant does not actually incur some of the transition costs borne by the 2G operators going forward and consequently should achieve a lower termination rate.

Failure to apply the benchmarking approach to all MNOs undermines the value in this principled approach. If Ofcom is unable or unwilling to apply the benchmark symmetrically then this approach is devalued and must fall away as the next best alternative to LRIC.

Ofcom correctly identifies the next question to be answered if it determines that price control for all should be based on some form of benchmark, namely, which benchmark is appropriate?

O2 notes with interest the principles that Ofcom is proposing to adopt in respect of the narrowband interconnect charges that BT ought to be permitted to levy in the context of its move from a PSTN to a Next Generation Network[4]. In our view, those principles apply as much to investment by mobile operators in 3G as they do to BT in its investment in 21CN.

We agree with an overall approach of providing as much commercial certainty to communications providers as possible in the context of major network investment where new technology is implemented, in relation to services required by regulation (such as mobile wholesale voice call termination).

Our view is that wholesale voice call termination charges should take account of:

- The need to avoid the creation of artificial arbitrage opportunities between existing voice call termination services provided on 2G networks and the same services provided by 3G networks, by taking a holistic approach to cost recovery that avoids artificially distorting the incentives for providers to use one technology instead of another; and

- The need to allow an appropriate return on mobile operators' 3G investments, taking into account the costs of migration and any 2G specific stranded assets.

Ofcom will recognise that it has proposed similar charging principles in relation to BT's investment in 21CN. In O2's view, Ofcom's proposed 'holistic' approach to narrowband voice interconnect charging is as applicable to mobile operators as it is to BT.

Consequently, if Ofcom is comfortable with this approach for fixed, O2 can see no reason for it to be reticent to apply identical principles to all MNOs in relation to 3G.

[4] Next Generation Networks: further consultation. Ofcom, 30 June 2005

The distinction between 900/1800 MHz operators and 1800 MHz operators

As we have set out in our response to the consultation on the proposed charge control modifications, O2 remains concerned that Ofcom's LRIC analysis continues to suggest that the cost of terminating a voice call on 1800 MHz networks is greater than that for 900/1800 MHz networks. In particular, this result rests on the assumption that networks were "rolled out" on a similar basis.

In fact, and as T-Mobile itself concedes, T-Mobile originally rolled its network out to a lesser extent, compared to 900/1800 MHz operators. O2 believes that amending the LRIC model to account for this fact results in a lower cost of wholesale voice call termination, to the extent that the cost of the service provided by 1800 MHz networks is identical to that of the service provided by 900/1800 MHz networks.

Furthermore, in the absence of migration of traffic to 3G, O2 notes that Ofcom's 2G LRIC model, even without the amendment proposed above, halves the difference between the 1800 MHz and 900/1800 MHz rates (from 0.68ppm now to the proposed 0.34ppm for 2006/07).

O2 therefore believes that Ofcom should remove the unjustifiable distinction between the termination charges that 1800 MHz networks are permitted to levy, compared to those levied by 900/1800 MHz networks.

The appropriate benchmark

In O2's opinion the appropriate benchmark would constitute:

- The updated LRIC+ approach for 2G networks outlined in Annex E of the short-term consultation, but amended to remove the distinction between 900/1800 MHz networks and 1800 MHz networks, as set out above;
- Mark ups for common costs and externalities, as Ofcom proposes; and
- A mark up to take account of transition costs and dual running of 2G and 3G networks, in the same way that Ofcom proposes that BT should be allowed to recover analogous costs incurred during the migration to 21CN.

O2 would not expect such a common charge control to be less (in real terms) than its present average regulated rate of 5.63ppm.

When should this apply?

As we have set out in our response to the proposal to modify the charge controls, O2 believes that Ofcom will have sufficient clarity as to the uncertainty of the 3G LRIC model, as early as autumn this year. If the CAT rejects '3's appeal of its significant market power designation, Ofcom should consider implementing a benchmarked price control for all MNOs by April 2006.

Length of the charge control period

Clearly, current and future investors in mobile operators would benefit from longer term certainty as to the revenues and costs that such companies will be incurring over the medium term, in order to place appropriate valuations on those companies and their future prospects.

A charge control which lasted to 2009/10 would cover at least the start of a major period of uncertainty, including spectrum auctions, decisions about liberalisation of mobile spectrum, the extent to which MNOs migrate traffic to 3G and the costs of decommissioning 2G networks.

Furthermore, it would allow empirical data on 3G networks and their costs for call termination services to be collected; should Ofcom wish to revert to a LRIC approach in the future.

Question 10 Should mobile termination of mobile originated calls be subject to lighter regulation than mobile termination of fixed network originated calls? If so, what form might that regulation take?

As a matter of principle, O2 does not favour the imposition of unnecessary regulation.

O2 notes that SMS wholesale pricing, which is still essentially mobile to mobile, is not currently regulated. You will see from our response to question 11 that we believe firmly that any such intervention would not be justified in SMS pricing. O2 believes that there may be an analogous position with respect to voice between mobile operators. That is, wholesale voice call termination charges are "netted off" to an extent and the absolute level of charges has less impact on retail charges.

However, there would always be an arbitrage opportunity if fixed to mobile and mobile to mobile calls were at different prices. This may over time bring the two prices into line which would obviate any benefits from having separate prices in the first place.

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Question 11 Is it appropriate for Ofcom to forebear from considering the imposition of regulation on termination of data services?

O2 agrees that it is right for Ofcom to forbear from considering the imposition of regulation on termination of data services, for the reasons stated in the consultation document. Most data services are pure RPP in any case and therefore no data termination problem (as Ofcom might see it) exists.

The European Commission has not specified the termination of data services as a market susceptible to ex ante regulation.

As Ofcom is aware, services are priced according to the amount of data sent or received, and so the calling party pays principle, which Ofcom believes to be the basis for designating SMP status in voice call termination, does not apply. In addition, many data services are new and emerging and it is generally inappropriate for Ofcom to regulate such services.

While it is true that the calling party principle does apply to SMS, virtually all of these are sent between mobile operators and so fixed line callers are unaffected. Wholesale charges tend to be "netted off" and have little impact on retail rates. Indeed, retail prices are below interconnect prices in some cases and there is therefore no constraint imposed on retail prices by interconnect arrangements.

For these reasons, Ofcom should not seek to engage in ex ante regulation in relation to data services.