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Amendment to the charge control on Mobile Network Operators

O2 (UK) Ltd ("O2") welcomes the opportunity to respond to Ofcom's consultation to amend the charge control on mobile network operators[1].

We have organised this response into four sections:

1. Ofcom does not have jurisdiction to amend the charge control as proposed
2. The proposed amendments are neither appropriate nor justified;
3. Ofcom's preferred option; and
4. Answers to specific questions raised by Ofcom

Ofcom will see that O2 is strongly opposed to the proposed charge control modifications, on a number of grounds.

Firstly, we do not believe that Ofcom has jurisdiction to amend the charge control in the manner set out in the consultation document. Through the proposed amendments, Ofcom seeks to extend the current price control, to cover the price charged by recipient operators for the termination of calls to ported-in numbers. O2 considers that Ofcom does not have jurisdiction to do this, as recipient operators do not have SMP with respect to the termination of ported-in calls.

In its Mobile call termination Statement[2], Ofcom concludes that calls to ported numbers form part of the market for termination on the network of the recipient MNO. O2 believes that this is clearly an incorrect conclusion. If O2 is correct in respect of market definition, then it follows that Ofcom has also failed to show that O2 or any other MNO has SMP in the separate market on which calls to ported numbers are provided (however that market might be defined). It follows that, as a matter of law, Ofcom cannot implement the proposals set out in the consultation document.

Furthermore, as Ofcom is aware, O2 has appealed the Statement, to the Competition Appeals Tribunal insofar as it applies to call termination for ported in numbers. The above issues are therefore currently being considered before the CAT. In O2's view, Ofcom should defer its consultation until this matter has been resolved.

Even if operators did have SMP in the market on which calls to ported-in numbers are provided (which they do not), Ofcom's proposals are, in any event, entirely unwarranted. Ofcom has not shown that the proposals would benefit consumers (which it needs to do in order to comply with its duties). The justifications which Ofcom has provided for the charge control amendment are flawed and not supported by evidence. The position that Ofcom proposes to adopt is also entirely inconsistent with its previous decisions.

In O2's view, therefore, Ofcom is not able to amend the charge control in the way that it proposes.

[1] Amendment to charge control on Mobile Network Operators. Proposals for consultation. Ofcom, 27 March 2007

[2] Mobile call termination statement, Ofcom, 27 March 2007

1. OFCOM DOES NOT HAVE JURISDICTION TO AMEND THE CHARGE CONTROL AS PROPOSED

O2 considers that Ofcom does not have jurisdiction to amend the charge control in the manner set out in the consultation document.

Through the proposed amendments, Ofcom seeks to extend the current price control, to cover the price charged by recipient operators for the termination of calls to ported-in numbers. O2 considers that Ofcom does not have jurisdiction to do this, as recipient operators do not have SMP with respect to the termination of ported-in calls. It follows that, as a matter of law, Ofcom cannot implement the proposals set out in the consultation document.

Market definition

In its Statement, Ofcom concludes that calls to ported numbers form part of the market for termination on the network of the recipient MNO. O2 believes that this is clearly an incorrect conclusion and that none of the reasons given by Ofcom in that Statement supports such a position. Ofcom gives five reasons for including calls to ported numbers within the market definition, each of which is manifestly flawed.

First, Ofcom claims that the competitive conditions for calls to different numbers are homogeneous:

"the competitive conditions relating to the provision of wholesale voice call termination to different numbers (or different subscribers) supplied by the same MNO to other Communications Providers are likely to be relatively homogeneous. This implies that a MNO's conduct when supplying wholesale voice call termination to other Communications Providers relating to a particular number (or subscriber) is likely to be similar to its conduct when supplying that service in relation to other numbers."[3]

This reasoning is clearly incorrect in the case of calls to ported-in numbers. Whereas in the supply of termination for a call to a non-ported number, the recipient network has a direct relationship with the originating network and sets the price for that call, in the case of termination for a call to a ported number the recipient network has no relationship with the originating network, and has no control over the price paid by the originating network. A crucial feature of the competitive conditions on the market for calls to non-ported numbers, namely the power to set price and the constraints operating in respect of that price, is therefore entirely absent in the case of calls to ported-in numbers.

Secondly, Ofcom claims that:

"there is a common pricing constraint i.e. in practice, given MNOs' billing systems, it would be difficult/costly for an MNO to charge different prices for MCT to different numbers (or different subscribers) even if it wished to do so."[4]

Again, however, this is clearly incorrect in the case of calls to ported-in numbers (as Ofcom itself admits), where the termination charge is set by the donor network and may be entirely different from the recipient network's termination charge.[5]

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[3] Statement §3.131, first bullet, and §3.134
[4] Statement §3.131, second bullet
[5] Statement §3.133.

In addition, Ofcom admits that it is "conceptually difficult to apply the SSNIP test in the case of ported numbers" since that test "examines competitive constraints on a hypothetical monopolist increasing the price of its output – clearly this presupposes that the hypothetical monopolist is responsible for setting the price of its output in the first place".[6] In fact, for that reason, it is not merely "conceptually difficult" but impossible to apply the SSNIP test to ported-in numbers, where the hypothetical monopolist has no power to set the price of the service.

Thirdly, Ofcom claims that *if* MNOs were able to set the termination charges for calls to ported numbers, then the conditions of competition for calls to non-ported and ported-in numbers would be relatively homogeneous.[7] Crucially, however, MNOs are *not* currently able to set the termination charges for calls to ported-in numbers. The conditions of competition are not, therefore, homogeneous. To posit an analysis that would apply under a completely *different* factual scenario does not provide any support for an analysis of the *actual* factual scenario.

Fourthly, Ofcom states that it is considering changes to number portability arrangements to require direct routing of calls to ported-in numbers. If that change occurred, this would not affect Ofcom's market definition, since the definition relates to the supplier of termination rather than the MNO who sets the level of charges.[8]

Here, Ofcom appears to be saying that *if* the market structure were to change to that which it is proposing in its Number Portability Review, then its market definition would *from that point* become correct. However, this is not a reason for adopting an incorrect market definition at the present time, or before such a change has occurred. Furthermore, reliance on such a change for its market definition at this stage prejudges the outcome of Ofcom's consultation, on which it has not yet taken a final decision.

Finally, Ofcom states that it does not consider "alternative approaches" to be appropriate. In fact, Ofcom only refers to a single alternative approach, namely the inclusion of calls to ported numbers in the same market as that of the donor network operator. Ofcom comments that in such a case "the situation would arise in which an MNO is supplying a service to its subscribers but the service is included in the market of a different MNO. It would be unusual for Ofcom to impose remedies on termination charges on an MNO when it does not supply the service to which the remedy applies."[9]

Again, however, this reasoning is manifestly flawed. At the outset, it is based on circular logic, which assumes what it seeks to prove: namely that remedies should be imposed. It also contradicts the approach taken by Ofcom in relation to the termination of calls to Hutchison 3G on the network of Hutchison's national roaming partners. In such cases the call is terminated on the 2G network of one of the other MNOs, but the price is set by Hutchison. In such a case, Ofcom has found that the terminated call falls within the market for call termination provided by Hutchison, and may be subject to charge controls, despite the fact that Hutchison does not itself provide the service.[10]

[6] Statement §3.133 and footnote 27
[7] Statement §3.133, first bullet.
[8] Statement §3.133, second bullet.
[9] Statement §3.133, third bullet.
[10] Statement §3.164.

Significant market power

If O2 is correct in respect of market definition, then it follows that Ofcom has also failed to show that O2 or any other MNO has SMP in the separate market on which calls to ported numbers are provided (however that market might be defined). Ofcom gives no separate consideration to market power in relation to calls to ported numbers in the Statement. Its only comment, in the section of its Statement addressing the assessment of market power, is the observation that:

“As discussed in section 3, MNOs do not control the charge for all the calls they terminate due to the current number portability arrangements. Nevertheless it is Ofcom’s view that porting has no impact on SMP in these markets as these arrangements do not constrain MNOs’ ability to set [call termination] charges in respect of non ported numbers.”

That reasoning indicates that the features of termination of calls to non-ported numbers do not affect Ofcom’s reasoning in respect of SMP for the termination of calls to ported numbers. However, it does not in any way indicate that the criteria for SMP are also satisfied in relation to calls to non-ported numbers.

Furthermore, even if Ofcom were to carry out a proper assessment of market power on the market on which off-net call termination for calls to ported-in numbers is provided (which it has not), it could not conclude that O2 had SMP on that market. That is because, as Ofcom admits, in the case of calls to ported-in numbers, O2 does not have any control over the price charged for termination. It follows that it cannot be said to be in “a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers”[11] in relation to those calls. Nor could it be said to have the power to "*raise prices by restricting output without incurring a significant loss of sales or revenues*", which the European Commission's guidelines describe as the measure of market power in an ex ante environment.[12]

Appeal to the Competition Appeals Tribunal

As Ofcom is aware, O2 has appealed the Statement, to the Competition Appeals Tribunal insofar as it applies to call termination for ported numbers. The above issues are therefore currently being considered before the CAT. It is only after Ofcom has defined correctly the appropriate call termination market and assessed SMP, that it can institute a remedy. Furthermore, should the CAT remit this matter back to Ofcom and Ofcom subsequently determines an alternative market definition, or SMP finding, then the legal basis for the proposed charge control modifications will have fallen away. In light of O2’s and others’ appeals of the Statement, continuation of this consultation process appears to O2 to be a poor use of Ofcom’s limited administrative resources.

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11 Article 14 of Framework Directive, implemented by section 78 of the 2003 Act.

12 Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (2002/C 165/03), see: http://ec.europa.eu/information_society/topics/telecoms/regulatory/new_rf/documents/smp_guidelines/c_16520020711en00060031.pdf

2. THE PROPOSED AMENDMENTS ARE NEITHER APPROPRIATE NOR JUSTIFIED

Even if operators did have SMP in the market on which calls to ported-in numbers are provided (which they do not), Ofcom's proposals are, in any event, entirely unwarranted for the reasons set out below.

First, Ofcom has not shown that the proposals benefit consumers and therefore comply with its duties. Secondly, the justifications which Ofcom does provide for the charge control are flawed for the reasons set out below.

1. Ofcom has not shown that the proposals benefit consumers

As Ofcom notes at paragraph 4.4 of the consultation document, Ofcom's principal duties when carrying out its functions are:

- To further the interests of citizens in relation to communications matters; and
- To further the interests of consumers in relevant matters, where appropriate by promoting competition.

Furthermore, Ofcom is only entitled to impose price control conditions where it appears to them that the setting of the condition is appropriate for the purposes of (inter alia) "conferring the greatest possible benefits on the end-users of public electronic communications systems" (section 88(1)(b)(iii) Communications Act)

O2 is therefore surprised that Ofcom appears to have given very little consideration to the effects which its proposals can be expected to have on consumers.

First, the "revenue imbalances" which Ofcom claims to exist under the current arrangements do not self-evidently harm competition and, therefore, consumers. It is not therefore self evident that by consumers benefit by "correcting" them. In particular:

- There is no evidence (and Ofcom does not argue) that the current operation of the charge controls might result in the foreclosure of any operators, thereby damaging competition in the long term to the detriment of consumers;

- In the absence of foreclosure, there is no evidence that competition between operators is currently less intense than it would be if the amendments to the charge control were implemented.

At paragraph 4.24, Ofcom suggest that the current situation may encourage operators like H3G to compete less aggressively for the customers of other operators than they would do otherwise:

"*Further, if operator A persuades a subscriber from B to switch, the termination rate it receives for calls to that subscriber would be below its own termination charge, and possibly its underlying costs of providing termination. This might dissuade operator A from competing for B's subscribers. If a former B subscriber does switch to A, operator A may have an incentive to impede/not promote/make it inconvenient for that subscriber to port their number (so that A does not receive operator B's lower termination charge).*"

However, no evidence is provided to support this assertion, which is factually implausible.
[✂]

- On the other hand, Ofcom's arguments suggest that current arrangements result in operators competing *more* aggressively for H3G's customers than they would do otherwise. This point is illustrated with a theoretical example at paragraph 4.23:

"*Where operator A's termination charge exceeds operator B's termination charge, operator B may have an increased incentive to target A's subscribers (in the hope that they will port their numbers to B) to obtain higher termination revenue. This may create an adverse competitive impact on operator A whose customers are being targeted because of regulatory differences between the two operators rather than from normal competitive conditions. Operator B could also potentially face reduced competition for subscribers because Operator C will prefer to target its customer acquisition efforts against A's subscriber base as opposed to B's (given A's higher termination revenue)*".

If this is true, then the proposed amendments can be expected to reduce competition and therefore harm consumers.

Secondly, the proposals will clearly have a direct adverse impact on at least some consumers. For example, prices can be expected to rise for consumers who call H3G numbers, as H3G can be expected to raise its average effective charge as a result of the amendment. Furthermore, fixed line customers will be substantially worse off. As Ofcom acknowledges[13], fixed line operators would pay around £10m per year more for mobile voice call termination under the proposal[14]. Since Ofcom has previously argued that reductions in voice call termination rates are passed through to fixed line consumers in some form or other, it follows that Ofcom must also be of the view that the additional cost brought about by the proposed charge control amendments would be to passed to fixed line consumers, as well.

If Ofcom believes that it is entitled to disregard the interests of these consumers, or that the harm to their interests is outweighed by other considerations, then it should explain and quantify this. Such an assessment will provide a useful benchmark in future market reviews for what might be described as *de minimis* detriment to BT and other fixed line operators and their customers.

2. Ofcom's proposals are in any event unwarranted

Ofcom cites two reasons for its proposal to amend the charge control. Ofcom believes the charge controls, as they stand:

1. result in effective average termination rates (taking into account both ported in minutes and directly routed minutes) different from MNOs' TACs and that this is undesirable; and
2. have the potential for distortion of incentives in retail markets.

For the reasons below, O2 does not believe that these reasons withstand scrutiny.

[13] Consultation §4.49
[14] At least in the first year of the charge control

(a) Desirability of allowing MNOs to recover TACs and costs

Ofcom expresses concern that the effect of the present charge control is that MNOs' effective average termination rates (taking into account ported-in minutes) will differ the TACs which they are currently required to meet for directly routed minutes. This is, of course, nothing new – the same was true under the previous charge control and Ofcom has spent the last eighteen months establishing the current charge control regime on this basis.

In any event, Ofcom does not appear to have advanced any reason why it is desirable for MNOs to set their effective termination charges at the level of the TAC . For example, if an MNO's effective average termination rate is currently *below* the TAC, it does not appear to be in the interests of consumers for Ofcom to permit that operator to raise its termination charges to meet the TAC.

TAC is not equal to costs

It cannot be argued that it is desirable for operators' effective average rate to be equivalent to the TAC in order for operators to recover their efficiently incurred costs. For three of the four years covered by the charge control, TACs are higher than costs (in the case of H3G, considerably so). It follows that there is no potential for under-recovery of costs except, perhaps, in 2010/11 only. However, even this is unlikely as Ofcom has proposed that MNOs move to a form of direct routing by September 2009. If direct routing is implemented at any time before April 2010, then there is no prospect of any operator failing to recover its efficiently incurred costs (as determined in the Statement).

O2 notes Ofcom's sudden change of heart about the treatment of ported in minutes. Such a *volte face* is particularly surprising given that Ofcom has been unconcerned in the past about whether operators' effective average termination rates enable them to recover their costs. Under the previous charge control, 2G/3G MNOs were required to set TACs at the level of costs. Because the charge control excluded ported in minutes, it follows that the 1800MHz operators (whose TACs were higher than the 900/1800 MHz operators) failed to recover their efficiently incurred costs through their effective average termination charge between September 2004 and March 2007; Ofcom clearly understood the implication of its previous decision but did not consider it of sufficient concern.

Inconsistency with the treatment of national roaming

In setting the charge controls themselves, Ofcom elected to ignore other factors which have an effect on the costs and revenues associated with the provision of mobile voice call termination services, broadly on the same scale as the effect of onward routing of ported in minutes. In proposing to deal only with one factor (ported in minutes), and not others, Ofcom appears to be acting arbitrarily and inconsistently.

Specifically, when considering the cost to H3G of providing voice call termination services in the calls to mobiles market review, Ofcom chose not to consider the effect of national roaming. National roaming allows H3G to buy voice call termination services from another mobile operator on a wholesale basis, to enable H3G customers to receive calls in circumstances where H3G's own network would not provide coverage. H3G is charged the termination rate of the other mobile network operator for this service, yet itself charges its standard termination rate to originating and transit operators, in respect of such traffic (ie, it has the ability to set prices in respect of this traffic). Since H3G's termination rate is to be higher than that of its national roaming partner for the duration of the charge control, it follows that H3G will make an (unearned) profit for such calls.

It is instructive to consider the scale of such unearned revenues. [✂]

In dismissing the effect of national roaming in the charge control statement, Ofcom notes that the volume of H3G traffic that is terminated on its national roaming partner's network is expected to be small in 2010/11, and that the effect of national roaming would, therefore, be negligible. However, the same could be said for the effect of ported in minutes – because operators' rates are to converge, the differences between revenues implied by the TACs and actual charges will reduce substantially throughout the charge control period and, in 2010/11, it will be insignificant.

In any event, Ofcom's reason for the proposed charge control modification is that it is concerned that operators will not achieve their TAC (as opposed to an analysis of the effect of onward routing on costs, the reason for rejecting the effect of national roaming in the charge control statement). [✂]

Ofcom has no objective justification to ignore idiosyncrasies of the charge control that benefit H3G and seek to amend those which disbenefit H3G – such an approach would be inconsistent with section 47(2) of the Communications Act. In light of the recent appeals of Ofcom's Statement, it may be that an opportunity will present itself in due course for objective analysis of these analogous issues.

(b) Incentives in retail markets

Ofcom suggests that the current charge control arrangements have the potential for distortion of incentives in retail markets. MNOs may face artificial incentives to encourage customers to switch networks and/or port numbers.

Since September 2004, all 2G/3G MNOs have been subject to charge controls which have not included ported in minutes and which, if Ofcom is to be believed, also have had the potential to distort incentives in retail markets. Furthermore, as we will establish, below, it is likely that the difference between "headline" rates and actual charges were greater for the previous charge control, than for the current one – if such distortion of incentives really exist, one would reasonably have expected to see them by now.

In addition, it seems to O2 that it is possible to analyse the extent to which MNOs attract subscribers from each other, the reasons why any targeting takes place and the extent to which switchers are encouraged or discouraged to port their numbers, so that Ofcom's hypothesis may be tested reasonably easily. However, we note that Ofcom has presented no evidence at all to support its assertion that MNOs' incentives are distorted in such a way or, if they are, that they act upon them.

O2 is highly sceptical of the idea that MNOs target the customers of a particular operator simply because of differences in termination rates. In practice, we do not believe that this happens. Indeed, what evidence there is appears to demonstrate the opposite to Ofcom's hypothesis. [✂]

In summary, unless evidence is provided that MNOs' incentives are distorted in the way Ofcom describes, we do not believe that Ofcom is able to rely on this proposition to support a change to the charge controls.

3. Ofcom's proposals are inconsistent with its previous decisional practice

In the consultation document, Ofcom seeks to justify the proposed charge control modifications by claiming that the impact of ported in minutes on effective average termination rates is likely to have increased, resulting in greater difference between the TAC and effective average charges when ported-in minutes are taken into consideration. As evidence for this claim, Ofcom notes that the number of ported in numbers has increased since 2004[15].

O2 does not dispute that the volume of ported in numbers (as distinct from traffic) has increased. However, it does not follow that this has increased any divergence between the TAC and the effective average charge. In analysing the effect of ported in traffic on operators' effective average charges, one must consider the volume of ported in *traffic* from each other operator, relative to direct traffic. O2 has undertaken such an exercise[16] and has concluded that the impact of ported traffic on call termination rates will actually be *less* under the present charge control than it was under the previous one. There appears, at least in relation to O2's charge control, no justification for the proposed amendment, on this basis.

[15] Consultation §2.24
[16] In relation to O2 traffic only - O2 is unable to consider the effect of the proposed modification on other operators because it does not information about their traffic.

Relative volume of ported in minutes

O2 has analysed the relative volume of ported in minutes over the last three years and forecast the same for the duration of the charge control, based on observed trends (over the most recent eight quarters). The graph below illustrates the results:

[✂]

[✂] O2 notes Ofcom's assertion that the proportion of ported in traffic "can be expected to grow as mobile penetration plateaus and MNOs rely increasingly on competing for their rivals' subscribers to increase market share"[17]. However, no evidence is presented for this. O2 believes that the scenario depicted by Ofcom is by no means certain. For instance, it is quite possible that mobile subscriber numbers will continue to increase (subscribers may choose to have more than one mobile device). Even if there is a plateau, MNOs might have different strategies. They may, for example, elect to reduce subscriber acquisition costs and retail charges in an attempt to retain more customers and focus less on acquisition.

The reality is that it is simply not reasonable to assume that the proportion of ported in traffic will necessarily increase substantially. The best assumption is that observable trends will continue [✂]

Impact of the charge control modification on operators' charges

We have analysed the impact of the ported in traffic to O2's actual average voice call termination revenue, relative to its "headline rate" from 2005/06 to 2010/11[18]. The graph overleaf illustrates the results.

[17] Consultation §3.3
[18] From 2007/08, using forecast traffic data, as described in the previous section

[✂]

Ofcom will note that the impact of ported in traffic is expected to be highest in 2006/07, a year when Ofcom was unconcerned about such an effect. [✂] For each year in the current charge control period, we believe that the impact will be less than this (and no larger than in 2005/06), and will decline each year. Broadly, the reason for this is that while the proportion of ported in traffic will increase, it will increase only slowly, and (importantly) the impact of this increase is outweighed by the impact of the convergence of mobile operators' TACs over this period.

This result is important, because it demonstrates that any alleged "distortion" to mobile operators' charges attributable to ported in traffic is likely to be less in the current charge control period than it was in the previous one. Yet, since December 2003, Ofcom has consistently disregarded the effect of ported in traffic on termination rates. Indeed, as recently as December 2005, Ofcom shunned the opportunity to rectify the situation when it "rolled over" the 2005/06 charge control to 2006/07, even though it did take the opportunity to amend other aspects (such as removing the Weights Adjustment Factor).

Further, the previous charge control established on this basis has not been challenged, even by those operators whose financial situation has been worsened by this policy, or by H3G. It seems perverse and inconsistent, now that the effect of the alleged "distortion" to headline rates is likely to decrease, for Ofcom suddenly to change its mind on the issue.

Conclusion

O2 believes that the "distortions" to mobile operators' "headline" rates due to ported in traffic is lower now than it has been in the past, and that it will reduce over time. Accordingly, we do not see how Ofcom can argue that the charge control modification is necessary now, when, previously, it had concluded that it was not. For this reason, we do not think that Ofcom's position can be said to be objectively justified.

4. Charge controls need to be considered in their entirety

It is clear that Ofcom made its decision about the charge controls, including the glidepaths, on the basis of non ported minutes only. If Ofcom now wishes to amend the charge controls to include ported in minutes, then it must be consistent, and reset the charge controls and glidepaths on the same basis.

Under the charge controls currently in place, the glidepaths for 2G/3G MNOs were established on the basis of the previous charge controls (that is, on the basis of the then prevailing regulated rate, excluding ported in traffic). H3G's glidepath appears to have been determined on the basis of H3G's headline charges immediately prior to the charge control (also excluding the effect of ported in minutes).

This is important, because had ported in minutes been included in the analysis, O2 and Vodafone's starting position would have been higher (because their average charge would have been higher than the previous regulated 2G charge). Conversely, H3G's average actual charge would have been lower than its contractual charge (reflecting the lower rate attributable to ported in minutes). Using average actual charges as a basis for glidepaths would therefore have resulted in higher charge controls for O2 and Vodafone and lower charges for H3G.

O2 is not necessarily advocating determining glidepaths using actual average charges (including ported in minutes) as a starting point, and then incorporating ported in minutes in the mechanics of the charge controls themselves. That approach may or may not be better than the current charge control as it stands (where ported in minutes are excluded from both the mechanics of the charge control and the consideration of the glidepaths).

However, both of these approaches are, at least, consistent – either ported in minutes are considered in the round, or they are not. This contrasts with what Ofcom is now suggesting, since, under the proposal, ported in minutes would not be reflected in operators' glidepaths, but they would be included in the charge controls themselves. This is inconsistent. Ofcom would be rewarding H3G with a relatively benign glidepath (which fails to reflect the fact that H3G's actual charges immediately before the charge control were lower than its headline rates), and rewarding H3G again by allowing it a higher charge control that incorporates ported in minutes. By the same token, O2 and Vodafone would be penalised, twice.

O2 is firmly of the view that this inconsistency is discriminatory and cannot be objectively justified. If Ofcom wishes to include ported in minutes in the charge controls themselves, then it must also revisit the glidepaths so that they reflect operators' actual charges immediately prior to the charge control. In light of the recent appeals of Ofcom's Statement, it may be that an opportunity will present itself in due course for objective analysis of these analogous issues.

3. OFCOM'S PREFERRED OPTION

Without prejudice to the above, O2 has the following observations on Ofcom's proposed charge control amendment.

1. Ofcom's analysis of the impact of charge control modifications is incomplete

Ofcom has attempted to assess the financial impact of the proposed amendments to the charge control (see paragraphs 4.46 – 4.49). O2 is concerned that Ofcom appears to have understated the impact, because it does not seem to have addressed the change in mobile operators' *costs* (as distinct from revenues) arising from the proposed modifications.

In paragraph 4.47, Ofcom notes the likely revenue impact on H3G, Vodafone and O2 of the charge control modifications. However, mobile operators' interconnect costs would also be affected. Specifically, since H3G's termination charges would increase if the proposals were implemented, it follows that this would impose greater costs on other operators, including O2 and Vodafone. These additional costs exacerbate the financial impact of the proposed charge control modifications.

Since it has not recognised the impact on costs, it follows that Ofcom's assessment of the effect of the charge controls is incomplete and insufficient for the purposes of section 7 of the Communications Act. Ofcom must conduct a complete and thorough impact assessment, and consult on it, before it proposes to make modifications to the charge controls.

2. Effect of the charge control amendment

Without prejudice to O2's appeal on market definition, Ofcom's proposed charge control modification appears to exclude traffic received by the dominant provider which is subsequently ported out (defined as "Direct Minutes"). Indeed, O2 notes that, given Ofcom's proposed market definition, Ofcom could not seek to include such minutes within the charge control[19].

Since ported out traffic is to be excluded from the charge control, O2 assumes that donor MNOs would be free to set any charge they choose for such traffic.

3. Proposal would exacerbate cost/charge differentials, distorting competition in the mobile outgoing market

We set out above the inconsistencies in Ofcom's proposed charge control amendment and its approach in relation to glidepaths and other factors which result in headline rates being different to average effective charges.

These inconsistencies are all the more serious given the relatively large difference between H3G's cost in providing voice call termination, and its regulated charge. For 2007/08, H3G's charge is to be over 2ppm higher than its cost[20] . The difference between O2's (and Vodafone's) cost and charge is about 0.5ppm. O2 made lengthy representations about the

[19] To do so would be to set an SMP condition in respect of a service outside the market in which the (donor) operator is dominant, contrary to section 87of the Communications Act

[20] The difference is greater still once the benefits to H3G of national roaming are taken into account

distortions in the outgoing market arising from differences between mobile operators' costs and charges in its response to the September 2006 consultation on mobile voice call termination - reference should be made to that for further information. For the purpose of responding to the current consultation, we note that the effect of the proposed charge control amendment is to *increase* those relative differences, distorting further competition in the outgoing market. Ofcom does not appear to have considered this point at all. In O2's view this effect of the proposed charge control amendment is inconsistent with Ofcom's stated objective of ensuring competitive neutrality and avoiding economic distortions, for example in the downstream retail market[21].

[21] Consultation §4.8, fourth bullet point

4. ANSWERS TO SPECIFIC QUESTIONS RAISED BY OFCOM

Question 1: *What are respondent's views on the appropriateness of Option 1 as a solution to the distortions created by the existing MNP mechanism on MCT?*

For the reasons described in section 2 of this response, we do not believe that a change in the charge controls would be warranted. Accordingly, we are firmly of the view that Ofcom should decide to adopt option 1, leaving the charge controls as they are.

Question 2: *What are respondent's views on the appropriateness of Option 2 as a solution to the distortions created by the existing MNP mechanism on MCT?*

Question 3: *What are respondent's views on the appropriateness of Option 3 as a solution to the distortions created by the existing MNP mechanism on MCT?*

Without prejudice to our response to question 1, we do not support either options 2 or 3, for the reasons presented by Ofcom.

Question 4: *What are respondent's views on the appropriateness of Option 4 as a solution to the distortions created by the existing MNP mechanism on MCT?*

For the reasons set out in section 1 of this response, we do not believe that Ofcom has jurisdiction to amend the charge control in the way it proposes. In any event, Ofcom's proposed amendment is entirely unwarranted and inappropriate, for the reasons described in sections 2 and 3.

Question 5: *Do respondents agree with Ofcom's conclusion?*

No, for the reasons set out in this response.

Question 6: *What do respondents think about Ofcom's proposed amendment to the compliance formula?*

Without prejudice to our response to question 1, O2 notes that, under the proposed charge control, MNOs would be free to set the termination rates of minutes that they subsequently port out to other MNOs.