I am Stuart McIntosh, I think a number of you know me, I have been at a number of these sessions previously and I head the Competition Group. I am going to Chair the discussion, but I have some colleagues with me to cover the specific topics that we have today.

**Agenda**

On the way down I was thinking what has happened since we last had one of these sessions and we have had the Digital Economy Act, we have had an election and we have a new government; so - not very much, is the short story. As you will have seen, the Government has begun to set out a number of its new positions on policy, particularly the last week in its announcements on universal service commitments in broadband, the sort of measures it might take to promote the rollout of superfast broadband. It is also giving consideration to what it is going to do on spectrum, in light of the direction that had been placed before Parliament by the previous government - a great deal of activity on the government and policy front.

In parallel we have been quite active, as I am sure you have been noting and we are going to cover three of the main themes that we have been working on, particularly in the telecoms sector, over these past few months. In particular, in March, we published a consultation document on wholesale local access and wholesale broadband access market reviews. Both of those are pretty important market reviews. The wholesale access market review is particularly important because in large measure, it is going to help clarify what the regulatory regime is going to be for the rollout of superfast services in the sense of the next evolution beyond LLU, which has been a great success over these past six or seven years.

In early April, we published a consultation document on mobile termination rates. As you will know, mobile termination and spectrum are the two things that we work on that have a big impact on the mobile sector. As you will also have seen, there has been quite a lot of comment from all sides on our proposals with regards to mobile termination rates, so we will be able to bring you up-to-date with our thinking on that as well.
The third topic we are going to cover is around net neutrality. Net neutrality is something which has been very controversial, sharply debated and tested in the US in recent years and is something which is moving up the agenda within Europe and we quite recently put out our initial consultation and our thinking in that area.

Those are the three topics that we are going to focus on this morning. We don’t have a specific session this time on spectrum. The reason for that is quite simply the Government, as I mentioned earlier, is still thinking through where it is going to come out from a policy perspective. However, ‘H’ Nwana, who leads our Spectrum Group within Ofcom, is with us today, so, time allowing at the end of the session, we will take whatever questions you may have. Obviously there may be a limit to how far we can go in answering some of the questions; some of the issues are currently with Government.

With that, what I would like to do first is to hand over to Gareth Davies, who will take us through what we have been doing in respect of the WLA and WBA market reviews. Gareth leads all our work in the fixed telecoms sector.

Wholesale Local Access / Wholesale Broadband Access

Gareth Davies
Competition Policy Director

Agenda

Thanks very much, Stuart, and Good morning. The purpose of this first session is to give you an update on the work we have been doing related to wholesale local access and wholesale broadband access. What I would like to do first of all is recap on the proposals that we set out in the consultation documents that were published in March and then provide a brief summary of the issues that have been raised in response to those consultation documents. Then say a little bit about the broader context in which we are putting forward those proposals, how we see the market evolving in future years and the relative role of the different remedies that we put forward, before saying something about our next steps.

WLA market review proposals

We are clearly in a new phase in terms of the provision of broadband services, with growing investment in fibre-based local access networks capable of delivering much higher speed services to consumers. The proposals that we set out in the wholesale local access market review consultation document are designed to provide a regulatory framework that will foster both investment and competition in the provision of those new services. Over the past five years or so, copper-based remedies, particularly unbundled local loops, have served us well in terms of providing a platform for the development of the market and the
supply of current generation services, but we do think that new initiatives are clearly required if the UK is to establish and maintain a strong position in the provision of higher speed services using fibre in the access network.

**WBA market review proposals**

Our policy objectives have not changed. As before, we want to promote competition and investment, which we see as being complementary forces in the development of the market. Also our diagnosis of the market and competition within it is unchanged. As in the last market review we are proposing a national market outside of Hull in which BT has significant market power, but we have identified the need for two new remedies, each of which we think will have an important role to play in the deployment of high speed broadband in coming years.

**Main issues raised in responses**

The first is what we’ve called virtual unbundled local access, or VULA for short, which can be perhaps best seen as a fibre equivalent of LLU. The most obvious equivalent to unbundled copper would be unbundled fibre - physical access to the cable, but that is not technically possible at the moment, given the way in which BT is proposing to roll out its next generation access infrastructure. So, in VULA we are going for what we think is the next best thing, which is a stripped down, active product, designed to give purchasing operators the maximum scope for innovation in terms of the services that they provide to consumers.

VULA will be available wherever BT invests in its next generation access infrastructure, which, on the basis of current plans, will be in around two-thirds of the country by 2015. It will be available in two flavours – one of which will use fibre all the way to the home, while the other uses fibre to the street cabinet and then copper for the final leg into the customer’s premises. BT plans to use those two variants in tandem, as part of its NGA roll out plans.

The other new remedy that we have proposed in the market review is access to BT’s ducts and poles, also known as physical infrastructure access, or PIA for short, for the purpose of providing superfast broadband services. This remedy, we think, is likely to have a role to play in the areas where BT rolls out fibre infrastructure, but will also be important as a means of reducing investment costs in areas where BT does not plan to do that, the so-called “final third” of the country. Alongside these new remedies there will be an important continuing role for the existing generation of remedies, the LLU services that I mentioned, as BT at the moment has no plans to pull out the copper in the areas where it installs fibre. In fact there is still some significant investment going on in LLU facilities, particularly in full MPF services, which can be used to provide both voice and broadband services.
There have also been some signs of increased interest in unbundled sub-loops from the street cabinet to the customer premises and that is a remedy that has been available for a number of years, but hasn’t so far been used to any significant extent.

Coming onto the wholesale broadband access market, this slide summarises our key proposals there. This is a market which sits downstream from the local access market and a key feature of the approach that we have used is the disaggregation of the market by geography. In the last market review in 2008, we proposed to define three separate markets outside of Hull, based on the number of principal operators operating within market one, including exchange areas where only BT is present; market two where there are two or three principal operators, and BT, we have proposed, should have SMP (significant market power) in both of those markets. Market three, on the other hand, includes exchange areas with four or more principal operators and here we think there is a sufficient level of competition that no regulation is required.

The proposed approach to market definition that we have set forward in the recent consultation document, is the same as in 2008, although the boundaries between the markets have shifted: some exchange areas have moved from market one to market two, from market two to market three, as competition has developed.

In terms of remedies, the main change is the proposed charge control in market one and this would replace the price saving commitments that BT gave about five years ago and would provide an increased level of consumer protection in those areas where competitive provision is very unlikely to develop. We also proposed a fairly standard set of remedies in markets one and two, such as “no undue discrimination”, and cost orientation requirements.

What have stakeholders made of our proposals? In the local access area it is fair to say that there is a broad consensus on the proposed market definition, on BT’s market power and on the case for introducing the two new remedies that I have mentioned. The debate here centres particularly on specification of the remedies. Whilst nearly all of the respondents agreed with the high level requirements that we set out for VULA, a number of the larger operators argued that we should be more prescriptive about the features of the product and should look more critically at the extent to which BT’s GEA services currently delivers them. In particular they argued that BT should be obliged to produce a road map for the introduction of a wires-only version of those services, as soon as technical standards permit. We are currently looking closely at that question.

Several of the operators also questioned whether GEA meets some of the other requirements laid down for VULA, for example, that it should provide dedicated capacity. Some pricing issues were also raised. Most stakeholders accepted there is a case for giving
BT a significant degree of freedom over the pricing of its GEA products, but several expressed concern over the possibility of a margin squeeze between GEA and the price of BT’s downstream retail services, the Infinity product. We are currently considering how far we might go in terms of setting out how an issue of that sort would be addressed if it should arise.

In relation to PIA, the main comments have been around scope and timing. Several operators want more flexibility in terms of geographic availability of access to duct and poles, going beyond the local exchange and into the backhaul network and some argue that the remedy should not be limited in any sense in terms of providing a basis for just broadband services, but should also be available for use in terms of other services, such as leased lines. Again, we have not reached a conclusion on those issues, but are giving close consideration to the points that have been raised.

On the timing question, there was a general desire amongst the respondents, which we share, to bring forward the timetable for reference offers and product launch to the extent that that can be done and, if possible, to align the dates for ducts and poles. Our original timetable had BT producing a draft reference offer for duct by around the end of the year and there seems to be limited scope, we think, for bringing that forward. We are looking particularly at the timing of the poles reference offer. We proposed giving BT a further three months in respect of poles, but we are looking at whether that could be brought forward.

Finally, on local access, there were some calls to improve the existing LLU and SLU services, although the issues raised were generally given less weight by respondents and, in response, BT has argued that it should have some increased flexibility in terms of how those things are provided, so there is probably a more traditional division of views on those questions.

On the wholesale broadband market the main issues concern the market definition and the proposed charge control in market one. On the market definition side, BT have produced a lot of argumentation and evidence to support its view that exchange areas with three or more principal operators should be de-regulated rather than four or more, as we had proposed.

The European Commission also argues that as well as taking account of the number of operators we should also look at other indicators of competition, such as market shares. There have also been some developments in the market which affect our approach. In particular Orange are moving out of being an LLU provider and will instead be buying broadband services from BT Wholesale. That will reduce the number of principal operators in the market and, to some extent, change our market boundaries.
We have also been provided with some more optimistic rollout forecasts by some operators for LLU deployment. Given those developments, we think it is very likely that we will be re-consulting on the market boundaries in August because those developments do have a significant impact on the boundaries between particularly market two and market three. That will give us an opportunity to consider some of the arguments put forward by BT and others.

On pricing, BT argue that a charge control in market one would be disproportionate, as indeed, in their view, would a cost orientation requirement be in market two. By and large other respondents agreed with the proposed approach.

As I mentioned, we will be giving further consideration to all of those arguments and the other points raised in responses over the next couple of months before firming up our proposals and finalising them in the autumn.

Proposals in context (1)

Before wrapping up I would like to provide a bit more context for the proposals that we have put forward and a view on what we see as being the priorities. This slide summarises our approach to next generation access by geographic area. It is based on a division of the country into notional thirds. In the first third, which, rather confusingly, covers almost half of the population at the moment, both BT and Virgin already have network coverage and BT is intending to invest in its NGA infrastructure. Here the key regulatory remedy, we think, is likely to be the VULA product, which will enable other operators to enter the market and provide a competitive retail market for those superfast broadband services.

In the second tranche of the country, which covers around a further 15 or 20 per cent of the population, BT again has intentions to invest in NGA by 2015, so there should be a role for VULA here too. Virgin has no network coverage at the moment, but there may be some potential for it to extend its footprint on a commercial basis, to some extent, using BT’s ducts and poles. Virgin has announced that it has identified, I think, about a million homes in areas that could be covered in that way in the future. There may be some further potential for commercial expansion, either by Virgin or by others, in those areas. That, we think, represents a significant opportunity for increased investment and competition, based on PIA acting as a complementary remedy to VULA.

In the final third, Virgin has no presence and BT has no plans for the commercial rollout of VULA, so here the availability of superfast broadband is likely to depend largely on regional, or local initiatives, often with some degree of public funding. The Government’s plans will clearly be important here.
In terms of remedies, we think the duct and pole remedy could have a significant role to play in helping to reduce investment costs in those areas. Experience to date, for example, in South Yorkshire and Rutland also suggests that sub-loop unbundling could play a part, a supporting role, and we have had some discussions with BT about the scope for doing more to support those developments. Wireless technologies clearly will also have some role to play in those more remote areas.

For the next three or four years, which is the time horizon for the market reviews, we see the focus being principally on VULA and PIA. In the longer term, the expectation is that PIA will continue to have an important role as an option which allows cost of deployment to be brought down.

As for VULA, more will depend on the speed at which the technology develops. At some point, some form of fibre unbundling, such as wave length unbundling, may become technically and economically feasible as an alternative which provides even greater scope for innovation than does VULA. Whilst we might expect that to be the direction of travel in the longer term, the timing at this point is uncertain and some analysis that we commissioned, for example, suggesting that it won’t be feasible until around 2015, or 2016 at the earliest.

Proposals in context (2)

This slide just has a little more detail on our focus and priorities for the local access remedies that we think will have a role in supporting superfast broadband services. For VULA the priority will be to establish a fit-for-purpose VULA service, based on BT’s GEA product, to support competition, particularly in the first and second thirds of the country. That, we see, as including, importantly, effective switching and migration processes, there will also be important issues around service level agreements and pricing where we would expect industry to take the lead, but where we will be prepared to intervene if that is necessary.

For poles and ducts, PIA, the strategic focus is to support the additional investment in the middle and final thirds of the country. In the near term this will involve working with BT, with industry and with the OTA to ensure that BT’s reference offer is fit-for-purpose and does the job. At the same time, we will provide support as required for the Government’s initiatives, the market testing trials in the final third, for example, as discussed at the BDUK industry event last week.

At the same time we think that there are some things that could be done to support the use of sub-loop unbundling as a means of delivering next generation access in the final third and, to that end, we are talking to Openreach about the scope for providing, for
example, network data on the mapping of addresses to cabinets, that will help operators to plan their investments and about the case for reviewing and potentially updating the pricing for sub-loop services, which has been in place for some time.

Next Steps

The next steps for us will involve firstly publishing, as I mentioned, the re-consultation on the WBA market definition, most likely to be in August and around the same time we expect to publish a consultation as part of a strategic review of consumer switching. The aim of this review is to ensure that there are good consumer experience and competition outcomes from switching both single services and bundles, which obviously are increasingly important in the market. We see this as also being an important enabler of market development.

This will be followed in the autumn by statements on the two market reviews and also consultation documents on the associated charge controls covering LLU services and also for wholesale broadband access in market one.

We also expect to be actively involved in the implementation of the proposed remedies after those statements are published and that will include the provision of support for the Government’s initiatives for extending broadband coverage; that could be about extending a basic level of broadband service to poorly served areas, or it could be market testing of the faster speed services in the final third or, indeed, infrastructure sharing, which is the subject, of course, of a discussion paper published by the Government last week.

Thank you, we will now move to questions.

Stuart McIntosh: We will open for questions. Normal rules – if you could identify who you are and your organisation. One question plus one supplementary, initially; try and discipline this a little bit. I will try and manage round the room.

John Karidis (MF Global): Given how important superfast broadband is for the economy, what are the chances that Ofcom or the Government, or both, ask Virgin Media to start wholesaling its network or even opening its ducts and why are the chances, what you think they are?

Gareth Davies: There are three aspects of that. One is to do with our powers at the moment under the framework within which we operate. The only way in which we could impose an obligation of that sort on Virgin Media would be if we found them to
have significant market power. Obviously the market reviews we are conducting at the moment don’t currently reach that conclusion. We don’t have a basis at the moment, within the context of that framework, for imposing those sorts of obligations.

The second point is that the new EU framework, and Article 12 is the relevant bit of that, does establish that NRA should have the power to impose obligations for infrastructure sharing in a slightly new way, but it is not an unfettered power, it needs to be proportionate and for certain purposes. That new framework is clearly in the process of being transposed into UK legislation. We will have to see how that process works through and then consider what implications it might have in terms of whether it can provide the basis for the sort of obligation you are mentioning.

The third aspect is linked to the publication of the discussion paper last week by Government, where clearly they were inviting views on the scope for the potential for increased infrastructure sharing. It is too early to say where that is going to go. It is a very green document and the emphasis seems to be more on encouraging industry to come up with solutions that will allow that sort of solution to happen, rather than looking at legislation necessarily, but we will have to wait and see how that works through.

John Karidis: Thank you and if I may, just one supplementary.

Stuart McIntosh: I may have to amend that rule in real time!

John Karidis: Sorry about that. If you were not bound by the SMP issue, as a regulator who had been looking at this for ever, do you think in principle that Virgin Media should be made to wholesale access or open up its ducts?

Gareth Davies: It is not something that we have looked at in detail. It would obviously depend on the purpose of considering that. Virgin Media has been and is a pioneer in developing and offering superfast broadband services, so if the intention is to use that as a basis for widening the availability of those services, it is a little bit difficult to see how it would serve that purpose, given that the customers covered by the Virgin footprint already have access to those services.

We don’t have detailed information also on the practicalities in terms of the extent to which it might be feasible and economically sustainable to go down that path. We certainly wouldn’t rule it out; it is certainly something that we may well be looking at in more detail over time. At this time we can’t really give a firm conclusion on that point.

Matthew Howett (Ovum): Just going back to VULA, we have seen that the European Commission has a view that this is very much a transitional product and
eventually we should move to full unbundling. Certainly within the second draft of their recommendation, they do make quite a lot of noise about unbundling, regardless of the technology that is actually deployed. Do you have any plans to re-visit this consultation when we get a final recommendation from the Commission?

**Stuart McIntosh:** We would expect to do this when we next look at this market. I think we are anticipating that the VULA remedy will apply during the course of this market review and probably come back to it later.

**Gareth Davies:** That’s right. What we are doing is consistent with the recommendation, as we understand it, for the time being, but, as I mentioned, at some point in the future it may well be that VULA transitions into something that is closer to what the Commission would regard as full fibre unbundling.

**Paul Howard (JP Morgan Cazenove):** In the medium term, the key issue is going to be that the final third of the country that doesn’t have fibre, the Government is not in a particularly strong position to fund that. Is there any mechanism by which an operator could cross-subsidise the returns they ultimately make in fibre in the first third, into the final third? It seems like you are looking at them in isolation, whereas the telecoms industry has always grown up through subsidising rural areas from urban areas, if you see what I mean?

**Gareth Davies:** I think that is quite challenging, just because of the economics and the level of uncertainty over the business case for investment even in the first and second thirds is not as strong as it might be – it is open to question. If that is marginal, obviously that sort of cross-subsidisation you refer to would involve some increase in the pricing within the first two thirds of the country and it is not clear, I don’t think, at this point that that would be sustainable. It is certainly not something that we would have the power to mandate either, it would be more like something that could be considered by Government, I guess in the context of its initiatives.

**Stuart McIntosh:** It would seem that based on what this Government has said so far that they are expecting to give the market the opportunity to address this and the market’s so broadly defined. It is not simply the large players and lots of small companies might come into this. In the event that service is not being rolled out in the final third, they do seem to have indicated that they would consider making public funds available, but that is an issue for the future, I guess.
Damien Maltarp (Credit Suisse): On sub-loop unbundling, you mentioned that you had seen a bit more interest in it. In the past there have been question marks about whether sub-loop unbundling is economically viable. This increased interest that you are seeing, is that because something has changed? Also what do you think needs to change to sub-loop unbundling to make it a lot more economically viable going forward?

Gareth Davies: The interest has come from areas such as South Yorkshire, where the plans involve using sub-loops; also Cornwall, to some extent and Rutland Telecoms. Some of those initiatives are publically funded initiatives, and to some extent it reflects the fact that the technology has moved on and it is a little bit more feasible to put in a separate cabinet and to go down that route as a basis for providing sub-loop unbundled services. What we haven’t seen so far is much or anything significant in the way of cabinet sharing, so there could be some potential in that regard in the future. We did agree with BT that it would review the options around sub-loop unbundling and the potential for cabinet sharing for example, in the context of the variation that was granted some time ago, with regard to Openreach’s provision of GEA services and that review is going to take place in 2011. It will be interesting to see what comes out of that and whether it looks to be an increasingly viable option in the future.

Stuart McIntosh: One of the lessons from the LLU experience is that, as the technology matured and scale economies kicked in, it has been possible to push out sub-loop unbundling much, much further than many had anticipated originally, it was quite conceivable you could see the same phenomena in SLU as well.

Andrew Entwistle (New Street): My understanding is that VULA will be a full equivalence product, but I also understand that Openreach can offer volume discounts on it and, given that BT itself is likely to be the main customer for the VULA product, I’m just wondering whether that undermines the concept of equivalence and leads to the margin squeeze problems that you are alluding to?

Stuart McIntosh: You may be bringing us new news; I am not sure!

Gareth Davies: We said a certain amount in the consultation document about the potential for volume discounts and we wouldn’t rule them out per se, but clearly we would be very concerned if we thought that the impact of those discounts may, in any sense, be anti-competitive or might undermine the scope for others to compete. So we would look at that very closely if we thought that was happening, but I don’t think it is self-evidently the case that it would happen.
Simon Weeden (Citigroup): You have made a point about pole and duct sharing being a means to expand into the final third. BT has its plans that it has managed to come up with what looks like an economic case for going into the first two-thirds and BT has access to its poles and ducts. What is it that is different about the regulatory approach here that can possibly have a big enough impact on the economics of this to make a difference in the business case?

Gareth Davies: I think two things most obviously. One is there may be public funding available in the final third, which could further reduce the costs and the other is that some other operators have different business models and look at these opportunities in different ways. Rutland Telecom is an example of that, looking at small, community-based initiatives and seeking contributions in terms of investment funding from local residents as a basis for doing something. Those two factors at least could potentially make quite a significant difference.

Stuart McIntosh: We are running a little short of time so will take two more questions.

James Barford (Enders Analysis): In terms of no undue discrimination in markets one and two what would that mean a little bit more in practical terms, for example, does BT have to offer the same price to everybody and would it be able to offer selective price discounts, as it already does to some extent in market three?

Gareth Davies: In markets one and two I guess we would approach that on a case-by-case basis. It doesn’t necessarily rule out the potential for offering discounts to specified categories of customer, but what we think could well be undue discrimination would be if it is so selective it only applies to one customer, for example. We would have to, I think, look at it on a case-by-case basis to see what they were doing and whether it raised competition concerns. Usually people come to us if they have got those sorts of concerns.

Richard Crosthwaite (Sanford Bernstein): Other than possibly looking at VULA remedies for Virgin Media, have you considered how your thinking might change if BT were to fall significantly short of the two-thirds fibre coverage?

Gareth Davies: It would alter the picture in what I call the middle third of the country in the sense that you might not then have BT going out and providing an alternative service in that part of the country. The rest of the story would, I think, remain unchanged in
that the indications are so far that the economics are such that it may well prove to be commercially feasible for some operators, whether that is Virgin or BT or some of the other players, to expand and provide those services on a commercial basis in those areas. Obviously that would be not so good; it would be a disappointment, if that were to happen, but I don’t think it would alter the picture fundamentally with regard to the remedies that we are looking at here.

Stuart McIntosh: Gareth, thank you. I am mindful of time, so I think we will move on.

As I mentioned, the second topic that we are going to discuss is net neutrality, so Alex Blowers is the Director from our International team who will take you through the core of what we are consulting on at the moment – as I mentioned, we put out a document on this fairly recently.

Alex Blowers
International Director
Net neutrality

The internet traffic management continuum

Good morning, everybody. We have recently published what we term as a discussion document on the subject of traffic management and net neutrality. Net neutrality is a subject which probably most of us have had our initial exposure to as a consequence of the debate that has been taking place over the last couple of years in the US. That debate is a very far reaching debate; at times an esoteric debate; at times I would say almost a zany debate in terms of some of the issues that have been brought into play in that discussion. What we are focussing on here in the UK and what Ofcom is focussing on, is, I think, a more concrete manifestation of this debate, which relates directly to our regulatory responsibilities. That really is triggered by the widespread availability now and the increasing use by network operators of traffic management techniques.

What we are seeing is a general increase in the volume of traffic; we are all aware of that on both fixed and wireless networks. We are also seeing increasing consumer demand for applications and services which are particularly bandwidth hungry. It is an understandable response of network operators to be looking for ways to manage traffic in ways that are, if you like, efficient and allow the best possible outcomes for consumers in terms of the management of a scarce resource.
As this chart illustrates, there is effectively a spectrum of different kinds of traffic management techniques that can be used. Some of those techniques are I think it is fair to say, relatively uncontroversial. There is widespread understanding now that the idea of a truly neutral net in which all bits are created equal and all bits are treated equally is probably unrealistic. There have to be some forms of traffic management that at least distinguish between different kinds of traffic where consumers may have different degrees of sensitivity to delays or degradation in the service. So to take a very obvious example, I don’t particularly care if an email is delivered within one minute, two minutes or five minutes; I absolutely care if a voice call is dropped and I absolutely care if an IPTV service is degraded to the point where it becomes unwatchable.

The idea that network operators should be permitted to make certain kinds of distinction in the way that they handle types of traffic is relatively uncontroversial. What is much more controversial is where operators and ISPs start to distinguish between traffic on the basis of who has originated that traffic. Preferring their own traffic, using guaranteed quality of service mechanisms, for instance, over that of third party providers. Then, clearly, a set of issues are engaged around the scope potentially for that to be anti-competitive. There have been some cases where we have seen services being outright blocked by certain network operators or ISPs and a couple of these cases in the US have proven particularly controversial.

**Discussion taking place as part of a wide debate**

This debate that we are having here in the UK is taking place, as I have already said, in the context of a wider international debate that started in the US and the FCC there has proposed two important, new principles to address the questions arising from that debate. First, a strengthened principle of transparency in relation to the use of traffic management techniques: customers should know when traffic management is taking place and they should understand the implications of that. Second, a strict rule on discriminatory use of traffic management: what the FCC is proposing is that there will be a per se restriction on any discriminatory use of traffic management, for instance through the preferential treatment of services that I have just described.

This debate is also starting to be picked up elsewhere in Europe. We are seeing recent statements or consultations, or codes of practice being originated in a number of countries; I have listed some of them here and, indeed, I think 10 days after we published our discussion document, the European Commission published its own consultation on this which actually was similarly quite green in terms of exposing the questions and seeking information and data.
I should also say that all of this takes place against the background of the UK Government having to take a decision about how it will implement new provisions in the EU framework, which are directly relevant to this set of questions. So the new EU framework gives us a fairly strong steer as to how we should think about some of these questions.

**What is Ofcom’s role?**

What is Ofcom’s role in all of this? First of all we have some important existing powers in this area. Obviously, we have powers which already address the question of anti-competitive discrimination and those powers are both in our sector-specific remit, but also our Competition Law powers. So we have to consider whether there are sufficiently strong grounds to intervene using those existing powers in cases of discriminatory practice.

But the revised European framework also requires us to do some additional things. It gives us a duty to consider the need for the imposition of a minimum quality of service. I have put on the slide here the words that are used: “to prevent the degradation of services and the hindering or slowing of traffic”. It is not clear to us at this stage what the value of a minimum quality of service would be to address the problems that I have just identified of perhaps lack of transparency and scope for discrimination and it is not clear what a minimum quality of service means. The legislation doesn’t give us a great deal of guidance, but the way that we are thinking about that, the way that we positioned this in our discussion document is possibly something that we would think of as a longer-term option if we saw major structural change taking place in the internet that we felt required quite a substantial and significant re-casting of the terms of trade within the sector. So I think that is probably, as we see it today, a longer-term option for consideration.

Essentially what we focus on is those two questions of anti-competitive discrimination and transparency. On anti-competitive discrimination we should start by saying that it is not the case that ISPs, content providers, service providers and applications providers are currently banging down the doors of Ofcom with concrete examples of discriminatory practice that they would like us to take action against. Actually, the evidence of a problem here is massively outweighed by the rhetoric that is being generated about this issue as things stand today.

Part of the purpose of conducting a discussion in the way that we have sought to do, is to elicit whether that is the complete story. It may be that there are things bubbling under here that genuinely need to be surfaced as part of this debate and it is certainly not the case that we are ruling out that there are any problems already out there that would need to be addressed. We are trying to surface genuine concerns and perhaps move people from the rhetorical, skirmishing phase to actually making some real, concrete statements.
The second thing that we would highlight is that the anti-competitive behaviour in this area is not a given just because somebody happens to be controlling access to the consumer. So the starting point for the FCC’s approach to this is that there is a very low level of competition in retail services, broadband, ISPs, in the US; most consumers face the choice of a maximum of two providers. That situation looks very different here in Europe. We have been hearing about the measures that we’re taking actually to promote even more competition in what is already a highly competitive retail environment.

Why does that matter? Because the ability to conduct genuinely anti-competitive behaviour in relation to the use of traffic management is clearly going to be constrained by the market dynamics, the extent of competition. If I am a consumer and I don’t like the choices my provider is making in terms of the use of quality of service, the use of traffic management, I have, in a competitive market, the choice to move to another provider that might do things differently.

However, that links very firmly to the second area of investigation, which is the question of transparency. I can only exercise that kind of choice as a consumer if I know that traffic management is taking place. We have already seen evidence that traffic management is not necessarily widely understood or communicated when it is taking place and that suggests to us that the starting point for our activity in this area should be to promote a higher standard of transparency in relation to the use of traffic management techniques.

A lot of what we are talking about in the discussion document is trying to probe the question of what transparency can be delivered. Not transparency in the form of provision of reams of technical detail about how routing and switching is conducted within the network; that is probably not hugely helpful for consumers. Not transparency in the form of some very carefully crafted weasel words buried away in terms and conditions, which give the operator or ISP legal cover, but actually provide very little in the way of clarity about what will happen, but something which generates real and meaningful information, which consumers can both use at the point of sale, but also to understand what traffic management is taking place and how that might change over time with their existing provider.

What we are saying is that we want to work with industry to develop a model of transparency which has credibility because if we can do that, we do believe that some of the other broader concerns about net neutrality may start to fall away.

**Timing and next steps**

Let me just talk about next steps briefly. We are aiming to complete our process of initial discussion and investigation in September. We have timed that so we can provide
useful inputs, both to the European Commission in its examination of this issue, but also to
the UK Government as it considers how to transpose the new EU Framework.

Essentially, what I would say about the interaction of what we’re doing with what’s
happening at the European level is, there is no overwhelming appetite for further legislation,
进一步重大结构干预在这个领域，但我认为如果你仔细阅读，问题由欧洲委员会提出，它们非常可能在你说的领域，透明性工作，它能足够吗？如果不，我们需要进一步吗？因此，我们从一直在进行的并行的程序，将部分程度确定长期图景是，这样的长期政治和
regulatory concern in this area, leading to further action or legislation further down the line.

Our message to our stakeholders at this stage is very much come with us on this
journey of actually working out what the right answers are. That may actually help us to
avoid a long period of prolonged uncertainty about the need for additional legislation in this
area.

That is probably as much as I want to say on that. Thank you very much.

Matthew Howett (Ovum): Just a quick question. Have you done any work
that looks at what the incentives of investment in next generation networks might be if you
imposed legislation or rules which prevented some form of traffic management?

Alex Blowers: One of the things that we say in our discussion document –
going back to the point that this is a debate that is being conducted at quite a high rhetorical
level – there are two views that are being articulated. One is that if you allow traffic
management, you are undermining incentives to invest in NGA, because the response to
congestion, absent traffic management, will be to build a bigger, fatter, pipe network. The
other response has been from this and perhaps more from the network operator side, if you
don’t give us the freedom to actually manage our network in an efficient way, why would we
take a bit punt on investing in a new network which will face similar problems multiplied by
10? One of the things that we say in our document is we think that it is certainly not the case
that there is a straight line relationship between investing in traffic management techniques
or investing in network capacity. For many networks there will always be traffic management
problems because the access part of the network is inherently a contested medium.

Equally, because of the lumpy nature of investment, for instance, in backhaul,
because it is not a linear investment, it has to take place in increments, there may always be
a role for traffic management alongside investment in network capacity. The other thing that
we pointed out in our document is if we are right that this is an effectively competitive market, where consumers themselves will drive the right choices by providers, you would expect a network that gives more freedom, makes bigger investments in being able to do the things that you want to do without constraints, to win out, compared with a network that has a very, very restrictive approach to throttling down particular types of traffic at particular times.

**Chris Whitehouse (T Rowe Price):** I understand that you will allow operators to discriminate on their networks different types of services as long as they don’t differentiate the source, but are there limits to which you would allow operators to do that? For example, for mobile operators on VoIP will you set any restrictions on the differential pricing they can charge for, if you like, a bit of VoIP data? i.e. will they be allowed to charge similar as the equivalent, for example, of a voice bit, if you like?

**Alex Blowers:** There is a parallel of the debate that we were having earlier about infrastructure sharing. The starting point for us is the finding of significant market power, or finding of dominance using our competition law powers. Where we bear down hard on discriminatory practice, is where we find that there is a position of market power. That is a clear distinction from the approach that, for instance, the Americans are taking, which is that all platforms are deemed to have some degree of market power and hence rules will apply equally to any platform. One of the reasons why we are a bit wary of such an approach is because it does lead to some quite perverse outcomes, we think, in a UK context.

If we take the view that an ISP with 30,000 customers in the UK automatically has market power in any negotiation with a very large American firm called Google, that seems a slightly strange conclusion when what we are talking about really is the emergence of what we term a two-sided market, where network operators, content applications and service providers will be finding new commercial arrangements and relationships between them. Outright blocking is a difficult case and it is a case where we note in the document that concerns automatically arise with that. But as things stand, our power to intervene would really be limited to a case where we had an operator with significant market power in a relevant market.

**Chris Whitehouse:** Would it be a fair assumption to make that you would deem no mobile operator to have significant market power in voice?

**Stuart McIntosh:** That is the case at the moment.
Alex Blowers: It is the case at the moment. What we have to be careful about here is making outright statements about how we might conduct investigations, what might happen in the future. What I would contrast is our approach which, because of the nature of the environment that we operate in means that we always have to look at the facts of the case; we have to find that significant market power before we can introduce any kind of ruling or any kind of remedy from a per se approach that says, “There is bound to be a problem here; let’s just introduce rules up front which apply to all platforms”.

Andrew Entwistle (New Street): It is a follow-up question to Chris’ question, which is you don’t really have a designated market any more that is relevant to mobile net neutrality; there aren’t any retail mobile markets in the list. Would that hold you back?

Alex Blowers: We have always been very clear that the relevant markets list doesn’t have equivalent status to the tablets of stone that were handed down from the top of Mount Sinai; it is a starting point for a process of determining what are the right ex ante rules that apply using our sector powers? I don’t think that necessarily is an absolute constraint, but we are very clear that the facts on the ground today do not support the view that we need to intervene in the mobile retail market. I think those are the two points I would make on that.

Damien Maltarp (Credit Suisse): To understand the anti-discrimination versus market power point, if a service provider decided to charge the BBC a fee to provide a certain level of quality of service, is there any anti-discrimination going on there, given that any service provider could decide to charge the BBC that fee? Perhaps the BBC could afford to pay that, but perhaps a smaller content provider would not be able to afford to pay that. Is there anti discrimination there or is it just a matter that if you make consumers very much aware that this is going on, then you don’t have an issue?

Alex Blowers: Again, with a very big caveat that in a particular case we might have to look very carefully: the two points that we make in our discussion document, which is a discussion document, so we are open to views to the contrary, but the two arguments that we make there are first of all we don’t believe there is any per se reason to restrict the ability to charge in the so-called “two-sided market”. In other words, one model, which is the implicit model in the FCC’s approach, is that only the consumer should bear any charges associated with managing network capacity. We are saying that it may well be the right outcome that there is a distribution of those charges on either side of the market so
content, application and service providers may be asked to pay some contribution towards the cost of managing and operating networks. The question then is whether those charges are going to be, in some sense, unfair. What we note in the document is there is a set of concerns about potentially anti-competitive discrimination, which we have already talked about and I have already explained how we would think about those questions.

There is then a broader set of questions about whether the operation of such a market structure over time rewards scale in a way that leads to smaller content application and service providers losing out. I wouldn’t put the BBC necessarily in the first rank of smaller application concerning service providers, but that is a valid theoretical concern and what we say in the document is, “Can we illustrate that theoretical concern with some concrete examples of the way that the market might play out here?”

One of the counter examples that has already been put to us is if you think about the recent development of applications markets; if anything, entry barriers are reducing because network operators are seeing the case for making the availability of thousands and thousands of applications developed by thousands of application developers. That is what is attracting consumers to platforms. It doesn’t seem inevitable that the operation of a two-sided market will be that smaller players inevitably lose out. That set of concerns about longer-term, industrial policy consequences of the operation of this market are one of the things that we noted in the document may well be of broader concern to the European Commission and others.

**Stuart McIntosh:** In the interest of time we will probably have to call a halt there. Alex, thanks very much.

In what we have put out on this so far and in the discussion this morning, we have attached quite a lot of significance to transparency and we are going to be very interested to see how stakeholders respond to that, because if you like, the consumer proposition, the information that they will have, is even more complex than what they are faced with when they are buying broadband in the first instance. In that context we have had to do quite a lot of work to try and help consumers understand what it is that determines their broadband speed. This is taking it a level further, so it is going to be very interesting for them to understand how the industry proposes to provide that sort of transparency to consumers.

With that we will come onto our final session. I was thinking about introducing this by saying that David is the author of our most popular ever consultation document and I am not sure popularity is quite the way to describe it, but we have probably had more responses to this than anything we have ever published.
David Stewart: It is something to reflect on; it is quite a page turner of several hundred pages.

David Stewart  
Competition Policy Director

Ofcom’s proposals for mobile termination rate regulation 2011 – 2015

Good morning everyone. Some of you know me, my name is David Stewart, and I lead the spectacularly qualified team, who are really the true authors of our proposals in relation to mobile call termination. What I am going to do today is talk you through the proposals that we have made, some of the things that are coming out in the consultation process that we are going through now and talk to you a little bit about what is likely to happen moving forward, at least in terms of process.

Regulation of MTRs has a long history in the UK

Many of you will know because you have been close to this issue that since the mid 1990s, Ofcom and its predecessor Oftel have been setting rules to limit termination rates. The chart that you are looking at plots market growth, so in terms of subscriptions and the proportion of people in the UK who own or have access to mobile services, against the average termination rates since 1995. You can see the red line there linked to the right axis is the termination rate on average, which has fallen steadily over that period. The purple bars are the number of active accounts, which are plotted as a proportion of the total population and the green bars are the proportion of the people in the UK who use or have access to mobile services.

You can see that as things stand and, certainly running out to the end of 2011, when the current MTR regime expires, regulation will have reduced the mobile call termination rates year-on-year for nearly two decades. As we all know during that time mobile has grown from a luxury service offered to early adopters in the business market, to a mass market colossus which is currently bigger than fixed telecoms, corporate telecoms and broadband combined. During that time we have seen the market grow to the point where five out of six people in the UK have or use mobile services and, as the data shows there, there are three active accounts for every two users in the market. The proposals that we have published in April need to be seen in that historic context.

In April 2010, we proposed continued falls in MTRs for 2011 to 2015, applying to large and small operators

We are proposing for the period from 2011 to 2015 a further four year charge control on termination rates. I don’t think there is anything terribly surprising about that, given that
we have had successive charge controls and termination rates over such a long period. But this time there are some changes proposed which will need to be considered carefully. Under our proposal, rates will continue to fall and we will have a look at the numbers in a minute, but an important feature of the new proposals is the adoption of a different price calculation method. Today regulated termination rates are calculated using a method known as LRIC+. It calculates the incremental cost on a long run basis, of terminating calls and adds to that a mark up for the fixed and common cost of the network.

The European Commission has recommended that all European regulators move to a different cost calculating method, which we term pure LRIC and involves taking the incremental costs – the traffic-sensitive costs and using that alone to calculate the cost of terminating calls for the purpose of setting a regulatory rule.

An additional new feature of our proposals is that currently only national players who have large scale access networks have their termination rates regulated. We have proposed a regime based in symmetry against all mobile operators, including for example small operators who only serve a particular area, niche operators who are using new spectrum, either alone or in combination with national roaming and including operators who use alternative technologies like Wi-Fi or mobile VoIP. This would bring the structure of mobile call termination regulation into line with the structure of fixed call termination regulation, which is currently based on symmetry around BT’s regulated rates, although the level of termination rates would continue to reflect the differences in traffic sensitive costs between the two different platforms.

**In April 2010, we proposed continued falls in MTRs for 2011 to 2015, applying to large and small operators**

It is very important that everyone understands that these are simply proposals. We are in the midst of an active and vigorously contested consultation process. Industry players are lobbying hard, they are seeking to push the rate up or down as their commercial perspectives dictate, there is a hot debate about how long we should set a new charge control for, partly because the European Union is moving the framework in the direction of three year market reviews and, presumptively, three year charge controls and also because the timing of the introduction of pure LRIC in the recommendation falls during the period when any new charge control would occur.

The nature of cost modelling of course lends itself to detailed debate about the techniques used, the data that forms the inputs and so on and, as many of you will know, there are also one or two legal points that people are very keen to discuss with us about these proposals.
We are talking to everyone, we are listening to everyone and we are working out at the moment what further analysis and work we need to do to be able to take the proposals, the submissions that we have received in turn responding to those proposals and move forward to a final decision. We have also seen, as Stuart mentioned, compared certainly to previous mobile termination rate proceedings, which historically have been the preserve of the regulatory geeks and nerds – people like me, a strong response from the public and community groups, some responding to active campaigning, others taking an interest because of the high profile this issue gets in both the financial and business and the general press.

Our objective is always to act furthering consumers’ interests and so, as you would expect, it is always a very welcome development for us when members of the public take an interest in our work and give us their views directly. We always give that careful consideration. It is very gratifying to see that and it also underscores for us the fact that there is a real prize at stake in terms of getting the policy drivers right in relation to call termination.

I don’t plan to dwell on all of the aspects of this slide, but I think it is important to highlight that we see these proposals as bringing more coherence to termination regulation and that it is quite an important development that we clarify the status of all of the different users of allocations of mobile numbers and not simply the large players.

**Regulating all 07X numbers, not just national networks …**

Currently if smaller players cannot agree the price of call termination on a small, non national network, that argument falls to Ofcom to be resolved in a regulatory dispute. That may be sensible, it may even be the optimal way of dealing with those situations, when there is a very small number of them and they are very small players and therefore small numbers of consumers affected. But we are very conscious that, just as fixed telecoms has changed in the past 10 years, there is a lot going on within the very dynamic mobile sector that promises at least the possibility of further evolution of the sector, the supply chain and other arrangements in ways that may affect consumers. So in our mobile sector assessment we looked at the ways in which the mobile sector is facing various transformative pressures, with new players and new spectrum becoming available, alternative technologies like Wi-Fi or voice calls offered direct to a mobile application or over a mobile broadband connection.

Now is the right time to be thinking about how rules can remove barriers to entry and barriers to innovation in the sector by being technology-neutral and treating all calls to mobile numbers in essentially the same way, regardless of the technology that is used to deliver them. Again, we need to think very carefully about the responses to those issues in
our consultation because, while it is very easy to agree with the general statement that we should do all that we can to remove barriers to innovation and to have coherent policy, an important consequence is that we are regulating players who have not previously been regulated and that is never a step to be undertaken without very careful thought.

... with falling MTRs, irrespective of the policy choices ...

Turning now to the numbers and this replicates data that we published with our proposals, there has been a lot of attention on the proposed termination rates themselves. The chart that you are looking at plots our proposed charge control (which is the green line, using pure LRIC and, for comparison, what a charge control would look like using the method that we used in 2007 to set a charge control; that is LRIC+.

What leaps off the page, I think, is that termination rates are falling dramatically under either policy choice. That is good news for consumers, because what it tells you is that, at least on the basis of our cost model, that the price or the costs of delivering mobile voice calls are falling over time. That accords, of course, with common sense. We know that the mobile sector has continued to grow strongly in terms of call volume and we know that technology-mediated costs are falling across all of the sectors that we regulate.

This is a modelling exercise. Our model of users, available evidence about historic data such as revenue and volume data and the comparison, for example, the business plan of all the major players, which we gather under a process of statutory information-gathering and consider, to produce a view about what a reasonably efficient operator might do. Our model predicts that costs are likely to fall even further, essentially because 3G technology is maturing and when we last had a charge control in this area, it was still the case that 3G technology, as we saw it in 2007, projected to be modestly more expensive than 2G technology. By the time we reached a view in 2010, projecting out to 2015, that situation has reversed and 3G is coming into its own as a mature technology that is cheaper than previous generations of technology.

It is also true that mobile has grown and we predict will continue to grow as a total share of the nation’s telecoms activity. Essentially about between three and four per cent of all of the telephony in the UK, all the phone calls made in the UK have shifted from fixed to mobile over a number of years and that trend, as it continues, will deliver even further economies of scales to the mobile sector.

The other factor at play here is the fact that mobile data services, which have been growing strongly since their introduction over the past two years, will take a greater share of network activity, further changing the cost projection in relation to voice on its own.
This is a market where things are changing quickly and there are considerable uncertainties involved in any modelling process. At the end of the process all one can ever have is a reasonably well-evidenced and as rigorous a guess as one can possibly muster about market conditions in a dynamic sector, several years in the future. There are some things that we know already that we won’t know when we come to take a final decision. That is one of the reasons why it is important for our proposals to be exposed to a very active consultation process, for people to have the opportunity to look at them in detail, to look at the model in detail and to give us their thoughts on how it can be further improved.

... broadly in line with European trends

I began by giving some context by showing you MTRs and how they are falling over time, so it is probably in the ‘book end’ to that to look at it in a slightly different way which is to look at how MTRs are falling when we look at both the decisions of national regulators and the proposals of national regulators across Europe.

Broadly speaking, as the chart shows very clearly, the trend of falling termination rates is reflected across other member states within Europe. That is no accident of course, we all operate within a single framework set by the European Commission and operating under a common set of recommended policies. It is important to recognise that the outcomes for consumers that are seen in our markets and the kind of questions that we are grappling with in relation to termination rates, are likely to be the same questions, if not necessarily the same answers, that are being considered right across Europe.

MCT Review timeline

Finally, this is the timeline which helps illustrate what happens next. The formal period for written consultation is now closed. Of course, we are continuing to talk to those who made submissions and anyone else who is interested in talking to us. We expect to be in a position to take the final decision early next year. The current regime expires at the end of March 2011. Between then and now what we are really focussed on above all else is about how our proposals are likely to affect UK consumers. We are concerned about the direct effect on UK consumers in terms of how it might affect prices for both fixed and mobile services and we are also interested in the indirect effects and how it affects the overall health of the market, the state of competition in the market and the different features of competition, including innovation and investment. The focus for us now is to make sure that we are doing all that we can to gather the evidence and analysis that we need to understand how our proposals might be modified to make sure they are even more closely matched to our overall statutory objective, which is to further the interests of UK consumers.
Stuart McIntosh: Thank you David. I suspect there will be a few questions. Who would like to kick off?

James Barford (Enders Analysis): I notice the final statement is to be published relatively shortly before due to being implemented. Past experience suggests that sometimes that final guidance can slip, and in any case it will be far from over in a legal sense by the time that statement is published. There is also a note (on the slide) that there are bilateral meetings – I take it that is Ofcom and the mobile operators having meetings?

David Stewart: Mobile and fixed operators, people who have made submissions and our normal process of engagement with people who are interested in our decisions.

James Barford: Obviously you can’t say anything definitively, but can you give some ideas about are you making great efforts to make sure it is resolved by the time the final statement is out?

David Stewart: We are doing all that we can to make the right decision and I think one can’t escape the historically observable fact that, because there is so much commercially at stake, almost all of the previous decisions taken on call termination rates in the mobile sector have been the subject of litigation. It would be nice to think that there was a path that one could get to where one unveiled a final decision and people looked at it and went, “Gosh, that is such a clear decision that no-one need do anything more on that”. We need also to recognise the plausible reality that, taken at face value, if you look at the submissions that we got to our previous consultation, it was logically impossible to escape an appeal because you have some people saying, “If you do A, we think that would be the wrong thing to do and we would see that being raised in an appeal”. Other people saying, “If you do not do A, we see that as the wrong thing to do”. We have to plan for that, we have to take our decision as quickly as we reasonably can and of course we have a hard stop with the end of the current regime. I don’t think timing is the main factor here, I think the most important thing here is to get the right decision.

Stuart McIntosh: It’s probably worth adding that all of the main stakeholders who are affected by this within the industry have made very, very substantive inputs to it; which we are having to do quite a lot of work on to assimilate, and it is going to be quite a complex piece of work to get to a statement by the end of the year. I think we feel reasonably confident however that we will be in a position to publish, either at the end of December or during January.
James Barford: Just a supplementary; in terms of the contents of those meetings you are having with the mobile operators and the other stakeholders, would you describe those as negotiations, clarifications or …?

David Stewart: It is not a negotiated process.

Stuart McIntosh: No. It is not a negotiation. People have given us very substantial input and we look at that, we try and understand it and then we meet with the stakeholders to make sure that our understanding is correct and to give them the opportunity to embellish on that because there is an element to how far you can convey all of your points in the written word, but it is not a negotiation.

Matthew Howett (Ovum): Just a quick question related to pure LRIC. Does that approach allow for the recovery of costs associated with acquiring new or additional spectrum and can those costs be recovered or not?

David Stewart: The Commission’s recommendation, for example, describes the way in which and the rationale for it – largely excluding spectrum costs, essentially because they are common to a number of different services. That is reflected, for example, in the analysis which we published which showed sensitivity analysis for the different scenarios and you can see the LRIC+ number bounces about for example, depending on what views one takes about volume and including, critically, spectrum valuation. That is true whether you are talking about the valuation of existing spectrum, which is a factor that you can debate, or the question of new spectrum, but when you look at a pure LRIC number it is relatively insensitive to those things, and that is largely an artefact that that is mostly excluded.

Simon Weeden (Citi): Just on that very point, forgive me if you have touched on it already, but I am not clear given that you have a LRIC+ model, which provides a two-thirds reduction in the rate over the period that you are talking about, why go to pure LRIC at this point after the extended period of regulation on a different basis up until now.

David Stewart: That is exactly the question that we are grappling with: is that the right thing to do? We have a number of different factors at play. We have, all other things being equal, a very strong sense that we want regulation to be clear, consistent and predictable. We also have the Commission’s recommendation, which is seeking to bring a harmonised approach across Europe and that brings with it certain obligations. It is not a diktat that we simply must apply. What we are required to do is to have utmost account of
that and that involves weighing up the objective of harmonisation against issues like, “are there factors that are relevant to our market that would justify making it appropriate to take a different approach?”.

What we set out in our policy document was that, based on the facts as we saw them on 1 April, we saw the debate between pure LRIC and LRIC+ was finely balanced, but between those two choices, our inclination was to propose pure LRIC.

Clearly that is at the heart of the debate in our consultative process. We said what we thought candidly at the time, we are now looking with an open mind at the submissions that have been made, both in support of that position and in opposition to it. I am not sure there is a clear, single answer to that question, other than yes, exactly; that is what we need to think through.

One of the things that comes out of the fact that the two lines are so close to each other on the graph is that perhaps takes a little bit of heat out of the issue, but of course commercially there is still so much at stake that we owe it to all affected parties, not least of which are UK consumers, to get it right.

**Stuart McIntosh:** It is not the case that we unthinkingly apply the recommendation simply because there was a recommendation. There are other circumstances where we have chosen to depart from the Commission’s recommendations, because we thought the specifics of the situation in the UK justified that. If we felt that was appropriate in this case, we would come to a similar conclusion.

**David Stewart:** If I may follow up. An interesting point that has been made to us by a number of commercial stakeholders is to reflect on the fact that their reading of our policy document was that we had gone for pure LRIC, but not in what they described as very "enthusiastic way". It was a curious point which suggested that if we felt we were tipping one way or the other in this binary choice that we should then polarise and exclude our minds to the virtues of the other option or the shortcomings of the option that you propose to adopt. The truth is there are credible arguments to be made for both of these policy approaches. That said, we took the view that we did in the initial consultation on the basis that where we got to was the pure LRIC would drive some important benefits to UK consumers. The virtues of LRIC+ are well explored in the previous decisions, pure LRIC is the new kid on the block and we need to work through what it has to offer.

**Simon Weeden:** If I may throw up a supplementary: if I can ask you to elaborate on what the justification was for using LRIC+ in the first place, because obviously the audience here represents the investor community in one way or another and cost recovery was always a part of the regulatory structure which we quite liked, I think.
David Stewart: It is important to recognise the different tasks that we ask regulation to do in relation to cost recovery and there are important differences between services which represent one way access, where the service in question is recovering all of the different costs and there is no alternative mechanism to recovering those costs, other than some form of regulated price. An example would be LLU where if you want to reach a national audience for fixed services there is only one network that is going to be an essential input. If the fixed and common costs of those services aren’t recovered partly through that regulated charge, there is a gap.

I think that is quite different conceptually to an issue like call termination where, because there is two-way access and because it is only one component of a much more complex commercial picture, whether the other 85 per cent of the revenue is collected under competitive conditions, the question is are consumers better off having the guarantee of some of that contribution of fixed and common costs from a service from which there is no direct retail competition because it is collected on a wholesale basis, or is the UK consumer better off having those services that are competitive contributing to the fixed and not having any risk of distortions on the traffic sensitive side?

Stuart McIntosh: Thank you; are there other questions on this?

That has come to the end of the formal discussion we had around those three themes. I hope you have found it helpful, but as I said, we do have a few minutes and we can take some other questions. Before I do that, there is just one thing I want to flag.

Last time we had this session, we talked you through what we had been doing in relation to looking at BT’s pension and how the pension deficit is treated from a regulatory point of view. We put out a consultation document on that earlier on in the year. We will be publishing our next consultation document at the end of this week, so you should look out for that on Friday. I am not going to say anything more about where we are going to come out on that other than last time it was a very green consultation, in as much as we were setting up the issue for consideration. We have had a lot of input from a whole variety of different parties, we have now digested that and what we will put out on Friday will be our proposed position. It is not our final conclusion; it will be a proposed position. We will then get further input from stakeholders and we will come to a final conclusion on this later on in the year. You should look for that.

With that, if you have any immediate questions that we can help you with, if we can we will. Andrew?
Andrew Entwistle (New Street): It is a spectrum question; probably no surprise there. Looking at what happened in the German auction, whether Ofcom is open to the possibility of coverage obligations in the 700MHz/800MHz band auctions that will be going ahead at some stage in this country and whether you see coverage obligations as being compatible with technology neutrality?

Stuart McIntosh: It would probably be best if I ask ‘H’ to cover that, unless you want to do the competition questions in future and I will do spectrum?

‘H’ Nwana: To answer the question, the first part of the answer is really one for government policy. As you know we are still waiting on the Government to instruct us on what to do with both the 800MHz and the 2.6 GHz options. We understand they are considering what they do exactly to answer the first part to your question. The second part about technology neutrality, I missed that piece.

Andrew Entwistle: Just whether coverage obligations are compatible with a technology neutral approach to an auction, because, by definition, if you are obliging somebody to cover an area, you are implying that they are going to use that spectrum for something specific.

‘H’ Nwana: I think there is a balance of view there clearly, to the extent that coverage obligations may mandate if the Government mandates a certain specific technology in order to do that particular coverage; fine, it is a matter for Government. But I don’t think we take a dogmatic approach in that particular regard to technology and service neutrality. Sometimes we do get perhaps a bit misunderstood, because we always have to balance technology and service neutrality in not pushing it too far to a point where it ends up sterilising a piece of spectrum, and that is no benefit whatsoever to consumers and citizens. But at the same time we don’t also want to necessarily mandate it if we believe, and the evidence in the marketplace suggests, that people genuinely have different perspectives as to how to use spectrum. It is always a balancing case.

Stuart McIntosh: I think now you have had it!

Question: Moving back to the general agenda, whether it is held in the EU or whether it is done by the Commission here, no doubt you will have the input on the Sky / News Corp situation. What competitive issues are you going to be looking out for in terms of trying to work out whether there will be an increase in competition, resulting from the acquisition?
Stuart McIntosh: The truth of the matter is we haven’t begun to think about that at all. In the event that it does become a proposed transaction and it goes to the Competition Commission, we will have a discussion with them, as we did in some of the other recent mergers that we have worked on with them and we will take it from that point. We are not at all advanced in our thinking of it.

Question: Just going back to spectrum, because of the fact that we have this situation that we have this delay to awarding the bands, I know we missed the deadline of the European Commission’s imposition of the re-farming decision. Aside from the fact the operators can’t re-farm the spectrum, is there a consequence financially, as a fine for instance, for us missing that deadline?

‘H’ Nwana: That question, again, should be directed to the Government. Whatever direction we are going to get from Government, we hope it is also going to encompass that particular position. Clearly, as you know, there is litigation already from one of the mobile network operators in that particular regard, but again, it is really one for Government.

Stuart McIntosh: Any more questions? Thank you very much. I hope you found this useful; we will have another session like this probably in about six months’ time. Thank you again.

[Meeting concluded]