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**3 Group's response to the Commission's draft  
Recommendation on the regulatory treatment of  
fixed and mobile termination rates in the EU**

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## Introduction

This paper contains the response of the **3** Group in Europe to the Commission's consultation on its draft Recommendation *'on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU'*.

The **3** Group is part of Hutchison Whampoa Limited's telecoms division and includes the following operating companies in the EU: Hutchison 3G Austria GmbH, Hi3G Denmark ApS, Hutchison 3G Ireland Limited, H3G Spa (Italy), Hi3G Access AB (Sweden) and Hutchison 3G UK Limited (together, H3G).

The HWL telecoms division, comprising the **3** Group and Hutchison Telecommunications International, is the first global 3G operator, with operations in 10 countries<sup>1</sup>. Our 3G services were first rolled out in March 2003. The HWL Group had close to 18 million 3G customers globally and more than 14 million in Europe as of 26 March 2008.

## Summary

The **3** Group welcomes the Commission's consultation on a new approach to regulating mobile termination rates (MTRs) and, with it, the acknowledgement that the current regulatory approach is not working.

There is now widespread acceptance amongst industry analysts and academics that the current regulatory approach towards MTRs distorts competition in favour of large incumbent mobile operators and creates a barrier to growth for late entrants. National Regulatory Authorities (NRAs) are also increasingly recognising the harm to competition caused by the current approach to regulating MTRs. The current approach to MTRs is also harming consumers and holding back innovation. Given this recognition, the **3** Group welcomes the Commission's consultation on a new approach.

The **3** Group believes that the objective for the Commission and national regulators should be to move to a system without MTRs ('bill and keep (BAK)'). This would remove the competition distortions that arise under the current approach. It will also aid the transition to Internet charging principles. To the extent that the Commission's Recommendation helps to achieve this objective, the **3** Group supports it. However, the **3** Group also wishes to ensure that the Recommendation allows a transition to zero MTRs that best promotes long term competition and, in particular, does not harm the competitive position of late entrant operators.

Therefore, whilst supporting the main objectives of the draft Recommendation, the **3** Group would like to see the following changes:

- The Recommendation should set as its objective a move to zero MTRs.
- The **3** Group questions the Commission's continuing insistence on symmetric termination rates as a pre-determined outcome despite all evidence that this policy is harming competition. The Recommendation should explicitly allow higher MTRs for small operators until zero MTRs have been implemented.

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<sup>1</sup> Australia, Austria, Denmark, Hong Kong, Ireland, Israel, Italy, Macau, Sweden and the UK.

- Similarly, the assumption that an efficient new entrant operator will quickly and inevitably reach market share parity even in saturated markets lacks economic justification and ignores market reality throughout the EU. Regulation based on that assumption is dangerous and unjustified.
- The Recommendation should pay more attention to the transition. There is a real risk that the benefits of zero MTRs will be lost if during the transition period competition is harmed, for example, by an unthinking application of symmetric MTRs.

### **A change in policy is now required**

The 3 Group agrees with the Commission's assessment that current price controls on MTRs show different practices in different Member States and that the overall level of MTRs remains high. There does not even seem to be consensus among national regulators to reduce the MTRs of incumbent operators, with Ofcom in the UK keeping the rates largely unchanged at 7€cents for the period to 2011, whereas NRAs elsewhere already have lower MTRs and are anticipating further decreases (for example, PTS in Sweden and RTR in Austria).

The 3 Group supports the Commission's conclusion that a new common methodology is required. Recent academic research and empirical studies are reaching a consensus that the current approach to regulating MTRs in Europe is not working. It is distorting competition and harming consumers. Furthermore, it is unsustainable with convergence of fixed and mobile services and of switched telephony and the Internet. Regulators and industry analysts are increasingly recognizing the flaws in the current system.

#### *MTRs distort competition*

There is an increasing understanding of the possibility for firms with higher market shares to use high MTRs strategically to distort competition in their favour<sup>2</sup>. Recent studies typically examine the call externality. Consumers benefit from receiving calls. This means that, other things being equal, consumers benefit more from subscribing to a network where they receive more calls. If a large network can deter its customers from making calls to a small network, it reduces the value of that small network to potential subscribers. Large networks can do this by setting high off-net tariffs. Small networks can also set high off-net prices but the effect is not the same, since they have fewer subscribers and therefore less impact on overall calling patterns. This is why we observe off-net tariffs at levels far above other tariffs (such as on-net and to fixed networks).

At the same time, we observe on-net tariffs below the level of MTRs. All operators can set low on-net tariffs but the distortionary affects are greatest when practised by large operators that have the scale to affect overall calling patterns. Low on-net tariffs encourage on-net calls. A large network will have many on-net calling opportunities. Therefore, a potential subscriber will see that for many calls the large network offers cheap on-net tariffs, and certainly for more calls than

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<sup>2</sup> Relevant studies include: Parcu and Manganelli "Powerless Monopoly: call termination and new entrants" *Mercato Concorrenza Regole*, 2007, Armstrong and Wright "Mobile call termination in the UK" *UCL* September 2007, Cambini and Valletti "Information exchange and competition in communications networks" forthcoming in *Journal of Industrial Economics*, Hoernig "On-net and off-net pricing on asymmetric telecommunications networks" forthcoming in *Information Economics and Policy*, Cabral "Dynamic price competition and network effects" April 2007, Harbord and Pagnozzi "On-net/ off-net price discrimination and 'bill and keep' vs 'cost based' termination pricing" forthcoming, Carter and Wright "Interconnection in Network Industries" *Review of Industrial Organization*, 1999, Carter and Wright, 2003.

a small network can offer. This encourages consumers to subscribe to the large network and creates an additional barrier to entry.

The use of retail tariffs to create a preference in favour of a network is called a ‘tariff mediated network externality’<sup>3</sup>. Low on-net tariffs can be replicated by a small operator but with much less impact, due to its limited customer base. The small network must offer off-net tariffs at the same level as the large operator’s on-net tariffs or below in order to be competitive and grow market share, but this is expensive for a small network. It may even be unprofitable if the on-net tariffs are below the level of MTRs as is currently the case in several countries, with the consequence that the on-net prices of incumbents simply cannot be replicated by small competitors. This is, in effect, a margin squeeze directed at late entrants by incumbents.

Through a combination of high off-net and low on-net tariffs large operators can make small operators unattractive for a prospective subscriber. Indeed, failing to address this distortion may make effective and sustainable entry by a later entrant all but impossible. The strategy of high off-net and low on-net tariffs leads to a further distortion. It creates traffic imbalances in favour of the large operator. The large operator deters off-net calls but to compete, the small operator has to offer low off-net tariffs, encouraging its subscribers to call off-net. This leads to small operators sending more interconnection traffic than they receive. With symmetric MTRs this results in a transfer of profit from small to large operators, which cannot be in the interests of long-term sustainable competition.

A system of zero MTRs would remove the main drivers of traffic imbalances and therefore significantly mitigates the disadvantages attached to having a smaller market share. In any event traffic imbalances would no longer entail a transfer of profit as occurs with MTRs.<sup>4</sup> If these distortions are not properly addressed by regulators they will increase as more operators enter the market. There is no point encouraging competition by, for example, reforming spectrum policy, if these tariff mediated network externalities are allowed to create an insurmountable barrier to entry.

The conclusions of the recent studies are confirmed by empirical evidence of the functioning of Europe’s mobile markets. High off-net and low on-net tariffs are common in many European markets. In some cases on-net tariffs set by the large operators are below the level of their MTRs. This is the case in Italy and Austria for example.

These tariff strategies have led to systematic traffic imbalances between late entrant and incumbent mobile operators. The size of the differences may reflect local conditions such as market fluidity (itself dependent on factors such as the effectiveness of number portability) and the extent of on-net/ off-net pricing, but their almost uniform existence supports the conclusion that they are a significant concern for late entrant operators.

In some markets these traffic imbalances have led to the late entrant operator subsidising large incumbents. This is the case in Austria and the UK, for example.

A further distortion from the current approach to regulating MTRs is that it often gives more profit to large operators than to small operators. While termination rates are above cost

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<sup>3</sup> Laffont, Rey and Tirole “Network competition: II. Price discrimination” *RAND Journal of Economics*, 29(1), 38 – 56.

<sup>4</sup> A further remedy that regulators ought to consider is a non-discrimination obligation, whereby the incumbent is required to offer a termination rate equal to the internal rate implied by the level of its on-net prices.

(including a 'normal' profit), operators are earning a margin on them (that is, they are a source of 'excess' profit). The more termination minutes, the more the excess profit. Those termination profits can then be used to distort competition in the retail market. So, when regulators set MTRs above cost they are granting large operators more profit and a competitive advantage. What is even more distortionary is that those excess profits are paid for by direct competitors.

This is evident from figures provided by the Austrian regulator. According to the regulator's own estimates, its price controls that set a glide path to symmetry, allowed the incumbent, Mobilkom, to earn an excess termination profit (that is, revenues above the regulator's own estimate of cost) of €296 million over the 5 year price control period (2004 to 2008). By comparison the regulator allowed 3 Austria termination profits of €17 million over the same period.

The 3 Group believes these distortions are reducing the competitiveness of mobile markets and harming consumers. These reasons alone require an urgent change in policy. However, there is also increasing recognition that the high MTRs of incumbents are harming consumers independent of the distortion of competition.

#### *MTRs harm consumers*

As well as the harm to consumers through the competition distortions, the high MTRs of incumbents also directly lead to consumers paying more for mobile services.<sup>5</sup>

First, high MTRs keep retail prices high. According to ECTA, consumers in Europe are paying around €10 billion a year in excessively high MTRs. This is equal to an overcharge of about €20 per year for every citizen. The Austrian regulator's estimate of excess profits from MTRs (above) implies an annual overcharge of €7 for every Austrian citizen, despite Austrian termination rates (at 5.76€cents per minute) being amongst the lowest in Europe. In the UK, high MTRs mean that each year every UK household pays around €40 too much for calling mobiles from a fixed telephone.

Comparisons with countries that have low or no MTRs show that those countries have lower average retail prices and higher average usage of mobile phones.

Second, high MTRs prevent the emergence of flat rate access pricing and of large bundles of minutes. The existence of high per minute charges for calls to incumbents' networks means that it is difficult for late entrants to compete on price, for example, by offering bundles with unlimited off-net calls. [Incumbents do not have this constraint because calls to late entrants are a small part of their customers' overall calling pattern.] The evidence from sectors where flat rate access pricing is available, such as fixed broadband and some fixed telephony, shows strong consumer demand for such tariffs.

Third, the high MTRs of incumbents are holding back innovation. This can be tariff innovation such as flat rate access pricing, but it is also innovation in new services. The 3 Group offers VoIP and Instant Messaging but few other operators do so. Most mobile operators discourage their customers from using these services by making them difficult to use, trying to block them or threatening to terminate the customer's contract. The reason for this is that VoIP and IM bypass call termination and so mean a loss of lucrative termination revenues.

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<sup>5</sup> The small market shares of late entrants means that the level of their MTRs has only a limited impact on average prices. In addition, the market positions of late entrants means that revenues from termination rates are passed on to customers in the form of, for example, lower retail prices or subsidised handsets. This is in contrast to incumbent operators, which are more likely to retain the revenues as excess profits.

*MTRs are not sustainable with convergence*

There are two aspects to convergence that are relevant to termination rate policy: (i) convergence of fixed and mobile services; and (ii) convergence of switched telephony with the Internet.

First, with convergence of fixed and mobile services, it is already evident that high mobile termination rates are distorting prices and competition. This is evident in the ‘home zone’ services that some mobile operators offer. These mobile services allow call origination and call termination at fixed prices within the customer’s home zone. In this way mobile operators can offer cheaper fixed termination rates to those customers who are price sensitive whilst continuing to charge much higher mobile termination rates to customers who are not. Mobile operators’ GSM Gateway products create similar arbitrage opportunities by allowing corporate customers to make on-net calls at low rates by avoiding call termination charges.

These services that substitute mobile calls for fixed calls are already showing the distortions from having mobile termination rates much higher than fixed termination rates. There are also questions about the correct treatment of dual fixed and mobile handsets. These services allow a call to be terminated via a fixed network and via a mobile networks and can, without the knowledge of the caller, switch between the two. In those circumstances, it is not always clear which termination rate applies.

Second, as switched telephony converges with the Internet the current termination rate system will become unsustainable. It is inevitable that the telecoms world will adopt the Internet charging principles of peering and transit; it is simply a matter of timing. In the long run two different charging regimes cannot exist together. The per minute call charges that are a consequence of high MTRs will be undermined by VoIP, which has no incremental cost for the consumer. It is most unlikely that the Internet will adopt the European telecoms system of termination rates. The Commission’s analysis concludes that, in the short term, some operators will try to block the evolution to IP. Convergence will not happen without regulatory intervention on MTRs. The WIK study on the future of IP Interconnect reached the same conclusion.<sup>6</sup> It is increasingly the differences in regulatory treatment of the services and not the underlying technology that is driving commercial behaviour and holding back innovation.

*Industry analysts recognise the competition distortions from the current system*

These findings are supported by independent industry observers. For example, in a research report dated 3 October 2007, Morgan Stanley noted that:<sup>7</sup>

*“High mobile termination rates are in our view probably the single most anti-competitive element of the European mobile landscape. They prevent deep price cutting by challenger or new entrant operators, as this leads to negative gross margins on outgoing calls (and indeed 3 in the UK has become a net payer of interconnection despite a very generous asymmetry in its favour).”*

Similarly, an editorial in the Financial Times of 16 June 2008, in the context of the Commission’s likely proposals, argued that:

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<sup>6</sup> The Future of IP Interconnection: Technical, Economic, and Public Policy Aspects, WIK Consult, 28 January 2008. WIK concluded that lower MTRs will be required with the evolution to IP interconnection.

<sup>7</sup> Telecommunications Services, Continuing Regulatory Pressure, Morgan Stanley, 3 October 2007.

*“[mobile] termination charges mean it is expensive for customers to call another network, encouraging customers to flock to the large incumbents, who offer more “on network” calls. That is bad for new players and bad for competition. Regulators should not intervene in markets without good reason – but here, the status quo is unacceptable, and market forces unlikely to sweep it away.”*

*Regulators are increasingly recognising the problem*

National regulators are increasingly reaching the conclusion that the system of MTRs and the on-net/ off-net pricing strategies they support are harmful to competition.

In its decision of 4 October 2007, the French regulator, ARCEP, allowed the late entrant, Bouygues, a higher MTR than the two incumbent operators on the grounds that above cost MTRs favour large incumbents and have led to the perverse situation where the smallest operator is subsidizing its two larger rivals. The ERG’s recent statement on termination rates also concluded that termination rates above cost favour incumbent operators.

As well as concluding that MTR regulation is harming competition, regulatory authorities are also finding that they need to deal with the consequences of the current regulatory approach. The German federal competition authority has launched an investigation into on-net/ off-net pricing strategies and the Belgian court recently gave a preliminary ruling that there are grounds to investigate further Proximus’ on-net/ off-net price discrimination.

### **A new policy on MTRs**

Given the recognition that the current system of MTRs distorts competition in favour of large incumbent operators and harms consumers, any new policy on MTRs must address these market failures. The new policy must also allow a smooth transition to Internet charging principles, given the inevitability of the changeover. Therefore, the 3 Group believes that the new approach to MTR regulation should have the following elements:

1. It should set as its objective a move to zero MTRs.
2. It should avoid competitive distortions and late entrants subsidizing large incumbents. In some markets this will mean the late entrant continuing to have a higher MTR than incumbents during a transition period.
3. It should have sufficient flexibility to permit NRAs to adopt a transition that best reflects national market circumstances.

### **The Commission’s proposals**

The 3 Group supports the Commission’s Recommendation to the extent that it satisfies these three elements. In particular, the 3 Group supports the Commission’s position on the following points:

1. The Recommendation should describe a consistent approach for national regulators. The 3 Group agrees with the Commission’s analysis that current costing methodologies leave too much discretion over how costs are calculated and recovered. This leads to inconsistency. It also demonstrates that there is no consistent view amongst national regulators over what constitutes efficient termination rates. Regulators using the same cost model have obtained

very different results, which are difficult to justify by objective differences and which are likely to be the result of policy decisions.<sup>8</sup>

2. The Recommendation should support the inevitable move to Internet charging principles. The 3 Group explains above why a system of zero MTRs (BAK) is more efficient than the current system of termination rates. In reality, with the convergence of switched telephony and the Internet, a move to the Internet charging model of peering (BAK) and transit is inevitable. By proposing significantly lower MTRs, the Recommendation will help in that transition. The 3 Group believes that the Recommendation should be more explicit in stating that BAK is the desirable policy objective.

The Commission's discussion of BAK raises the question of whether it would lead to arbitrage opportunities. This fails to recognise that there are arbitrage opportunities with the current system and BAK may resolve these.

GSM Gateways allow users to make a call from a fixed line to a mobile with the call routed directly via a GSM link to the mobile network so as to avoid paying a termination charge. It converts a call to the mobile network into an on-net call. GSM Gateways are offered by third parties (often illicitly) but also often by the mobile operator itself as a way of offering attractive fixed to mobile call rates to corporate customers. With BAK the possibility and need to avoid high MTRs disappears.

A further arbitrage opportunity that would be eliminated by BAK is 'international bypass'. International bypass operators have mobile number ranges allocated to them (or sub-allocated by a mobile number range holder), and receive termination rates at the mobile operator's rate without having a network. They offer international calls to mobile customers for no more than the cost of a standard domestic mobile call (which may well fall within a customer's bundle of minutes). The bypass operator then charges the mobile operator its full MTR but pays a much lower rate to an international operator for terminating the call. If the bypass operator's MTR were reduced then the relative cost of international termination would be greater and there would be a much reduced margin for the bypass operator.

The approach proposed in the draft Recommendation, if modified to reflect the 3 Group's concerns, would offer significant advantages to Europe's telecoms industry and consumers.

- A reduction in the burden of regulation. A move to zero termination rates would be a significant de-regulatory step by removing from regulation the most regulated part of a mobile operator's business, and by removing the need for intrusive cost modelling.
- A more level competitive playing field between incumbents and new entrants and between fixed and mobile operators.
- Lower retail prices for consumers by lowering the price floor for off-net calls and by creating a more level competitive playing field for late entrants.

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<sup>8</sup> For example, using the same cost model, Ofcom has concluded that MTRs in the UK should stay at around 7€cents until 2010 – 2011, whereas PTS has already imposed MTRs of about 4.5€cents in Sweden.

**The 3 Group therefore supports the main objectives of the Commission's proposed Recommendation.**

*Changes to the Recommendation*

While supporting the main objectives, the 3 Group would nevertheless wish to see changes to some aspects of the draft Recommendation and comments on these below.

1. Symmetric termination rates. The Commission's belief that all operators in a national market should have the same MTR even if large market share differences exist has never been fully justified. The key argument seems to be that in fully competitive markets all operators would have to charge the same price, which would be equal to the costs of the most efficient operator, including a normal profit.

This may, in theory, be true, when applied to fully competitive market conditions with, *inter alia*, undistorted calling patterns, fair allocations of spectrum, similar entry dates and very low switching costs for customers. In real markets, especially mature ones, the conditions of competition are very different. Distortions exist and markets are not always sufficiently fluid. A major obstacle to market fluidity in mobile markets is created by incumbents' offering tariff plans with large differences between low on-net and high off-net retail prices. The regulatory regime should not impose a hypothetical outcome on all operators whilst, at the same time, allowing market distortions that prevent the achievement of that outcome.

Whether all operators can achieve the same level of cost is a matter for objective assessment based on the facts. Different costs may therefore not relate to differences in efficiency but to objective differences in the underlying causes of cost, which are beyond the control of the operators. The Commission comments in the explanatory note that there may be objective cost differences between mobile operators (only) in "exceptional" cases. This is merely an assertion. The Commission has presented no evidence to show that objective cost differences are the exception. The scale effects inherent in mobile networks suggests that it will be the rule rather than the exception that later entrants have objective cost differences.

If there are such cost differences, asymmetric termination rates are not a form of entry assistance. They are simply applying the same regulation in a non-discriminatory way, taking account of objective differences.

The Commission's draft Recommendation (at recital 15) identifies '*uneven spectrum assignment*' as the only exogenous factor that can justify a different MTR. The 3 Group agrees that this is an exogenous cost difference but disagrees that it is the only one.

The 3 Group also disagrees that the '*cost disadvantage decreases as the market share of the later entrants increase.*' In fact, as the market share of the late entrant grows, uneven spectrum assignments are likely to put it at a significant and increasing cost disadvantage. The Commission's error is to think of uneven spectrum assignments purely in terms of the difference between 900 MHz and 1800 MHz (or indeed 2100 MHz) frequencies. This is an important reason for cost differences, but uneven spectrum assignments also exist in terms of the amount of spectrum operators have been assigned. For example, 3 Denmark has 2 x 15 MHz of FDD spectrum. Taking account of both GSM and 3G spectrum TDC has around 2 x 50 MHz and Telia 2 x 55 MHz. With refarming of 2G spectrum for 3G use, this gives 3 Denmark's rivals considerably more spectrum to offer the same services. They will be able to offer more services at higher speeds and at a lower cost with fewer base stations. As 3

Denmark's market share grows, rather than decrease, this cost disadvantage will increase. Similar situations exist in other Member States where the 3 Group operates.

Furthermore, the cost disadvantage from uneven spectrum assignments will not decrease, with or without secondary markets for spectrum, unless national regulators take action to re-assign spectrum to create a more level playing field. In Italy, for example, 3 Italy does not currently have any 900 MHz spectrum and will not have by 2011 (the final implementation date in the draft Recommendation) according to the NRA's current plans. Therefore, there is no basis for arguing that the cost differences will decrease and, therefore, no basis for reducing the current asymmetry in MTRs.

Even if the Commission was correct to conclude that static cost efficiency would require symmetric termination rates, this ignores dynamic efficiency. The whole project of telecoms liberalisation has been predicated on the basis that there are important benefits to be gained from introducing more competition in the sector. If the only objective were static cost minimisation, that may best be achieved through a monopolist, with suitable regulation to incentivise efficiency improvements. However, the underlying assumption of liberalisation is that, over the long term, dynamic efficiency gains outweigh any static losses.

The Commission claims that *'it is difficult to see how arguments regarding financial imbalances resulting from differences in traffic volumes and differential on-net/ off-net pricing would justify setting asymmetric termination rates'*. The explanation of this statement that follows it shows that the Commission has misunderstood the motives for high off-net charges. High off-net charges do not reflect the underlying termination charge. They are often several multiples higher than the termination charges. As explained in this response, high off-net call charges are a strategy to lower the value of a rival's network. Asymmetric termination rates have little or no bearing on the level of off-net call prices. Furthermore, the Commission overlooks the importance of financial imbalances. Financial imbalances are a transfer of profit from one operator to another, which distort competition. They are of primary concern to new entrant operators.

The continuing policy of symmetric termination rates ignores the recent academic work and findings of regulators and the ERG. Not only is it theoretically wrong but it is harming competition and consumers. The Recommendation must be revised to remove this distortion and to allow NRAs to adopt policies that prevent small late entrants subsidizing large incumbents.

2. Equal market shares. The annex to the draft Recommendation argues that the costs of termination rates should be based on an efficient operator, which is one with a market share equal to 1/ number of network operators. As with the policy on symmetry, there is no strong justification given in the consultation for this approach.

The 3 Group believes that an approach such as this, which relies on a hypothetical market structure, will never reflect market reality, nor provide efficient incentives to either late entrants or incumbents. The evidence of late entry over the last 10 years shows that the fluidity of mobile markets is so weak that smaller operators would need many years to reach their hypothetical market share, if such market shares are ever achievable (which the 3 Group doubts is the case in practice).<sup>9</sup>

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<sup>9</sup> For example, in the UK 60% of subscribers have never changed operator.

It is also not necessarily the case that only operators achieving an equal market share are efficient. This is a rare outcome in any industry.

Furthermore, setting costs according to the hypothetical market shares leads to perverse results:

- Above normal margins for operators with a market share above their hypothetical share.
- Below cost rates for operators with a market share below the hypothetical level.
- Consequently, a direct subsidy from small operators to their larger rivals.

3. Main competition concerns from termination rates. In the explanatory document the Commission identifies the main competition concern from termination markets to be excessive pricing. This is only one of the concerns. The Austrian regulator, for example, identified the following:<sup>10</sup>

- Allocative inefficiency due to high termination rates for calls from fixed networks.
- Allocative inefficiency due to high termination rates for off-net calls between mobile networks and the price discrimination between on-net and off-net calls.
- Foreclosure strategy by large operators towards smaller and new entrant rivals.
- Foreclosure of fixed operators from offering converged fixed-mobile products and fixed-mobile substitution.

In common with standard competition law practice, the Commission ought to be more concerned with, and therefore place more emphasis on, exclusionary practices rather than exploitative practices. The Commission's policy should be driven primarily by the objective of removing competition distortions, since this will lead to a more competitive market structure.

### **Transition from the old to the new approach**

The comments of Commissioner Kroes in the press release that accompanied the launch of the consultation indicate an expectation that the Recommendation will *'increase competition'*. The 3 Group agrees that setting zero MTRs as the ultimate objective will increase competition by removing the distortions of the current system, leading to a more efficient and competitive market outcome. However, given that there are distortions in the current system, the Recommendation must encourage national regulators to take steps to offset the disadvantages faced by late entrants until the new system comes into place. If, in the transition, national regulators do not offset the disadvantages faced by late entrants, the hoped-for increase in competition may never be realised.

In practice, the most damaging competition distortion arises when late entrants subsidise incumbent operators. At the very least, therefore, the transition to the ultimate objective of zero MTRs must be defined so as to avoid any subsidy. This will mean, in many cases, setting asymmetric termination rates to offset the traffic imbalances suffered by late entrants.

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<sup>10</sup> RTR, 2004

The need to propose a harmonised approach to MTRs stems from the lack of consistency in current MTR regulation. Recognising that Member States are currently at different starting points, the transition should also allow sufficient flexibility to ensure a smooth transition everywhere.

The Recommendation should invite NRAs to conduct a market review and impact assessment to identify the most appropriate approach to moving from the current to the new policy on MTRs. It should set out the requirements of the transition, such as the need to avoid a subsidy from late entrants to incumbents, and it should require national regulators to take the path that best meets those requirements.

The 3 Group anticipates that this could lead to different transition periods. The position of late entrants is different in different Member States and national regulators should implement transitional arrangements that are appropriate to their own market conditions in order to ensure late entrants do not face a competitive landscape that is tilted against them and are able to remain catalysts to greater competition. For example, in some countries, such as the UK, the current market distortions are leading to large subsidies from the small late entrants to the large incumbents. There a change in approach is urgently required, suggesting a short transition. Elsewhere, a longer transition may be necessary if the competitive position of the late entrant is not to be harmed. This would be the case in Italy for example.