Public Consultation on Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU

Response from International Telecommunications Users Group (INTUG)

Summary

Trade relies heavily on cross-border communications over fixed and mobile networks. Within and beyond the European Union ("EU"), trade flows are being hampered as a result of excessive costs for termination on fixed and mobile networks, and inconsistent application of EU rules by Member States and their regulators both *within* and *between* Member States.

It is regrettable that National Regulatory Authorities ("NRAs") in the Member States have not been more successful in reducing termination rates. As the Commission says, when mobile termination rates are €0.02 pm in Cyprus and €0.18 pm in Bulgaria, the Single Market is clearly not functioning as it should. The Commission therefore has every justification to act.

Furthermore, reluctance on the part of Mobile Network Operators ("MNOs"), to allow competition to develop on their networks is causing particular concern. The net effect of these problems is that significant damage is being done to the EU's economy, as, despite the passage of a considerable period of time, there has been no concerted attempt to grapple with the issues effectively. The current situation is a "tax on trade," which does not benefit business users or consumers. INTUG knows that the Commission has been asking Member States to act on this for some considerable time.

This paper sets out INTUG's response to the consultation, dealing specifically with the key themes raised. It explores why it is essential to consider other factors. Addressing Mobile Termination Rates ("MTRs") alone cannot achieve the goals of this consultation. A range of competition considerations arise, including matters concerning collective dominance, and potentially the current organisation of MNOs themselves. Particularly important is the need for steps to improve competition in the provision of services across all networks, and across national boundaries, which in the mobile market is not happening to anything like an adequate degree.

Questions on this consultation response should be directed to

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The principal objectives of the proposed recommendation on Termination Rates are to:

1. Support a **stable and balanced** regulatory environment which provides efficient investment incentives, promotes a level playing field between operators, and facilitates further reductions in termination rates to the benefit of European consumers.
2. Achieve **more consistent regulation** of call termination markets both within and across the Member States and thereby provide greater legal certainty to all.
3. Provide **clear and consistent principles** on the effective regulation of fixed and mobile termination rates in the EU.

INTUG fully supports these aims, and believes the Commission's focus on what end users will actually pay is really helpful, a theme developed in the Appendix to this paper. Looking at wholesale in isolation is not enough when retail rates have sometimes fallen below wholesale to the benefit of users.

At the most radical extreme, one could replace the whole regulatory regime with something completely different. INTUG does not believe this to be a viable option. However, operators (especially mobile ones) should be made aware that unless their behaviour changes they will face problems ahead.

The recently published WIK model of investment returns for incumbents and new entrants has merit in helping determine appropriate termination rate levels. The opportunity cost of avoidably high rates in the EU has been borne for long enough, and in a tougher economic climate, steps that promote trade and competitiveness are doubly important.

Given the asymmetry between user representative and incumbent operator resources for lobbying and responses to consultations, INTUG focuses on highlighting business users needs for effective and affordable transnational communications services, and the economic impact of regulation on growth, productivity and jobs. Business users have real concerns about the cost of telecommunications services in the EU. Recommendations leading to lower termination rates, such as apply elsewhere in the world, will be welcomed.

INTUG therefore strongly supports the Commission's proposals. At least as far back as 1999, it was recognised in the EU that Mobile Termination Rates (MTRs) and roaming charges were far too high. Action is thus long overdue. In order to ensure a globally competitive position is maintained, benchmarking should then continue to be undertaken to measure progress across the EU.

Specific Observations on the Commission Recommendation

The Commission's Recommendation represents a thorough and thoughtful position, well supported by experience from the real world. Greater consistency in the application of a common set of economic cost accounting principles would be a huge positive step in promoting competition.

INTUG accepts the Commission's contention that call termination can only be supplied by the network to which the called party is connected, and that there are currently no demand- or supply- side substitutes for call termination on an individual network. The rationale underpinning the need for ex-ante regulation is comprehensive, compelling, and critical if competition is to be stimulated.

Comments on some of the key themes are set out below:
"CWDP__" = Commission Working Document, Page__ to facilitate cross-referencing with the Document Text if wished)

How calls are paid for (CWDP 6,7,24-27)
Because under the calling party pays ("CPP") system, the called party is not billed for cost of terminating calls on his/her network, (s)he does not have any economic incentive to care about what his/her own network charges for this. The call originator has to bear the full cost, and this insensitivity to price helps to explain why rates have remained so high. From a purely economic perspective it would be "neater" to move away from CPP and expose the called Party to the portion of the cost (s)he causes, thereby increasing sensitivity to price, save of course that the called Party may well not attach the same value to the call as the calling party, and as the Internet continues to evolve, we are beginning to see new solutions emerge for interconnecting networks anyway. Not only this but the notion of a called party willingly bearing this cost when they are used to apparently getting the same service for free is unlikely to be well received by business users.

By the time the next review of termination rates takes place, there could be in a radically different world. INTUG therefore concludes that for now, CPP is probably the best way to proceed, notwithstanding the possible benefits offered by Bill and Keep, RPP, or some other solution explored by the Commission in this consultation.

Nevertheless, where alternative mechanisms emerge that might be beneficial for users (VOIP, GSM Gateways etc.), regulation should not be used as a weapon to prevent them. It might even be the case on occasion that a retail rate is offered which is below the wholesale termination rate as the result of a new technology being deployed.

This might sound illogical and impossible – but the situation has *already occurred* right across the EU and in Australia.

Potential efficiencies should be encouraged where appropriate, and if arbitrage is the way that such efficiencies manifest themselves in the market, then this will typically increase consumer welfare. The example of this occurring in practice within the EU was GSM Gateways. On the one hand the MNOs argued that Gateways caused congestion, whilst on the other hand making *retail* tariffs available that made arbitrage via GSM Gateways possible.

Cost Models – LRIC (CWDP 8, 13-15)
The recommendation refers to a model of perfect competition, a state that in the real world can rarely (if ever) even exist. Any approach to addressing the economic and accounting principles to underpin call termination across the EU should therefore, so far as is possible, be based on commonsense as well as theory.

INTUG believes the use of a forward-looking (current cost) long run incremental-cost ("LRIC") model commonly applied across the Member States represents a logical and sensible way to proceed (though perhaps it is not the only option available – see below). The additional benefits of a hybrid approach being able to compare a bottom up analysis of network costs simultaneously with a top-down one is that it produces a "range" within which the most accurate number is likely to be found. It also provides NRAs with a powerful basis upon which to justify their conclusions, adding legitimacy to the whole process.

The harmonised application of a standard model across the EU would stimulate investor confidence, since they would know for certain what to expect, and it would also make it easier to identify anomalies which today might well still be masked as a result of differing approaches to a common problem.

An approach designed to promote operator efficiency and prevent inappropriate costs from being recovered will also result in lower prices for business users and consumers. INTUG therefore supports the Commission's conclusions regarding exclusion of non-traffic costs, such as recovery of spectrum licence fees. If mobile networks overpay for spectrum they cannot penalise users for such a misjudgement.

As with all models, however, regular review is essential. INTUG are advised by their member in Australia (ATUG) that their NRA ("ACCC") used the "WIK Model" as the basis for regulation to reduce average domestic termination charges from A$0.22 pm to A$0.09 pm.

The US wireless termination rate is $0.0007 pm, dramatically lower than in the EU. This pricing structure has seen a rapid growth in customers, lower prices, and an average monthly usage per handset of 834 minutes compared to 189 minutes in Australia and 153 minutes in Europe. The evidence is clear. Lower prices lead to higher volumes.

INTUG urges the Commission to verify whether the WIK model might be applicable within the EU. WIK has recently completed a study for ECTA on the economics of Next Generation Access (NGA), which is highly relevant. This model has already been used to run a range of possible scenarios including for Sweden, Germany and France, which will no doubt be of assistance in helping to determine the levels at which termination rates could be set. The reasons for the much lower termination rates in the USA are complex, including some element of called party pays, but with termination rates so different, action is needed urgently to reduce this tax on trade in the EU.

INTUG also believe that regular benchmarking will be of value in order to ensure the harmonised adoption of common standards.

Symmetry of Remedies (CWDP 9, 16-18)
INTUG supports the Commission's contention that termination rates should normally be symmetric over time, and that any asymmetries must be justified. Operators who enter a market late and are unable to become efficient over time must not be permitted to hide behind higher rates, as this would distort competition and keep prices artificially high.

INTUG has sympathy with arguments that "3" has presented, and their strategy has resulted in lower prices and more consumer choice than might otherwise have been available in Europe. The strategy has been consistent in the EU and Australia, where the "3 like home" on-net (including International) roaming offer is markedly more competitive at A$0.35 pm than other alternatives.

Most EU MNOs claim they will suffer financially if they have to reduce termination rates. In fact, evidence suggests that the characteristics of the price elasticity to demand curve for their services are such that any margin erosion will be more than offset by increased volumes.

One consequence of new entrants like "3" having to work within the current regime is that they claim it forces up prices to end users. Their CEO noted recently that in the UK they pay £190m pa in termination revenues per annum to other operators. As they have fewer customers their mobile-to-mobile costs under the current regime are significantly higher than those of the established operators and this reduces their freedom to set lower retail rates.

Choice of Technology in Fixed and Mobile Networks (CWDP 20)
INTUG members are less interested in the underlying technology deployed than whether or not they can obtain the services they require at reasonable prices. However, the Commission's analysis in this area is extremely important, because INTUG expects a marked fall in costs with Next Generation Networks (NGN). Even though INTUG might prefer not to see any allowances at all made for any legacy equipment (for example the conversion of voice packets to/from IP packets at the edge of the network), INTUG believe that the Commission has adopted a sensible approach in the recommendation in this regard.

INTUG sees a possible issue concerning mobile capacity upgrades. Capacity costs to the extent they are caused by wholesale voice call termination services and not by coverage, may prove highly subjective to determine, and lead to exploitation by MNOs. It could be the case that costs are recovered, which were allegedly incurred as a result of wholesale voice call termination, but which were actually for a capacity upgrade which had nothing to do with wholesale voice. INTUG does not see any easy answers to this problem, but based on previous conduct on the part of MNOs, INTUG remains concerned.

Migration to IP Interconnection (CWDP 26)
INTUG shares the Commission's view that in migrating to IP networks, short-term inefficiencies resulting from operators' own choices should not serve as a justification for higher termination rates for any length of time, though of course this should not include any legacy equipment deemed "necessary" for the derivation of termination rates.

As the Commission notes, if call termination rates remain at current levels, many fixed and mobile network operators might choose not to migrate to IP-based interconnection. The conclusion drawn is that "given the current high level of termination rates, the evolution of IP interconnection is likely to be slower and any transition to alternative charging mechanisms is likely to be significantly impeded."

This reinforces the wisdom of the Commission proposed approach, which INTUG believes will stimulate the market. INTUG would like to see the fastest possible migration to NGNs.

Functional Separation and Mobile Network Operators
Based on some positive experiences with fixed network operators, INTUG suggests the Commission might explore whether there is merit, perhaps as an exceptional remedy, in having functional separation available for application to MNOs.

They have shown some aversion to open competition over their networks, and have direct sales channels like fixed network operators. Some have vertically integrated businesses, and if this is deemed to be a potential bottleneck obstacle to fixed network competition, this might also be considered a barrier to entry for the mobile market.

Encouragement is required to stimulate greater transnational mobile competition. If adequate progress cannot be made in lowering mobile termination rates, and in increasing effective competition, functional separation could be used to create real economic value benefits.

The mobile market exhibits some symptoms of collective dominance over what might be considered an essential facility. The Commission may need wider powers in order to deal effectively with such conduct. The European Framework Review should be used as an opportunity to address this more effectively.

Observations on how competition is being distorted by Termination Rate levels and why this must also be addressed

In the 13th Single Telecoms Market Progress Report, the Commission noted that 86.5% of fixed telephony users still used the incumbent's network for access (and over 95% in 12 Member States). 46% of broadband lines still reside with incumbents.

Because of the greater attention given by NRAs to fixed line operators, it comes as no surprise to learn that prices within the EU are generally static, whilst year-on-year traffic volumes have fallen some 5%. It is generally accepted that functional separation of BT in the UK, with the creation of Openreach, has been a success, and the equivalence undertakings agreed with the NRA have delivered more competition.

Despite this, BT felt it necessary to go to the Competition Appeals Tribunal to obtain a judgement against MNOs in August 2008 and in which the Court itself set the lower rates BT sought for fixed to mobile termination.

If regulation was working smoothly at the National level, then such a dispute would most likely not reach the Courts. Quite often in telecommunications disputes (though not in this case), one Party is much smaller than the other. Typically pressures on Courts mean that there is a considerable delay between a dispute starting and eventual resolution. In one termination related case, the dispute has lasted over 5 years, is still unresolved, and the smaller company involved has gone into liquidation. This is bad for competition, as it is stifled routinely because of the “asymmetry of size” between operators. Not everyone is rich enough to take on the might of Vodafone, as BT did.

Another nagging concern is that spectrum pricing, typically with NRA managed auctions, may compromise the very independence that NRAs must have - to the detriment of operators of “fixed only” networks. When the sums raised in auctions are in the billions of Euros, loss of independence becomes a risk. The Commission is independent of such pressures, and therefore has a doubly valuable role to play when disputes arise.

Overall, fixed line termination rates from other fixed networks are much lower then mobile-to-mobile or fixed-to-mobile, principally because of the level of competition from other fixed networks, from VoIP, and to some extent from mobile services. A CEO of one of the major Mobile Networks made no secret of his desire to grow his business by encouraging residential fixed network customers to give up their landlines completely and migrate to mobile.

Since rebalancing in fixed networks produced higher line rental prices but lower call charges, this proved attractive to some consumers, but migration does not also mean that usage has increased. The real aim is often for low volume users to avoid a monthly rental charge. Their migration stimulates competition by forcing the fixed networks to keep monthly rental charges at sensible levels that the market will bear, and call charges competitive at the retail level. (Retail tariffs and the benefits of monitoring them in parallel with wholesale pricing are covered in the appendix to this paper).

Fixed Networks appear to have borne the brunt of NRA attention because they have been around longer, were initially far larger, and, in the case of the PTTs, it was possible for the NRA to make a significant impact on the market in proportion to the amount of resources necessary to achieve results.

The genesis of the original LRIC modelling was in the fixed market. However, the bulk of INTUG's comments are focused on the mobile market, reflecting the fact that business users' mobile costs are increasing rapidly relative to their fixed bills, and hence this is where their many concerns arise. Increased costs are a warning sign that competition might not be operating as it should.

This response comes as Vodafone announce sharp price increases in one Member State, with prices for pay-as-you go customers rising by 30%, due in part, they claim, to "regulation". It is widely believed that MNOs are raising prices to recoup some of the lost revenues from recent regulatory price caps.

MNO profits benefit significantly from excessively high mobile call termination rates, since build costs for a new mobile network are only 20% of new build costs for fixed networks, (the major cost differential being duct installation).

INTUG is concerned at the behaviour of some MNOs in bringing disputes about termination rates to the Courts, rather than keeping them within the regulatory environment. An MNO can trade-off the cost of litigation (which it has a greater ability to fund when compared to the majority of its customers) against the scale of lost profit a dispute might cause to its business, and see which option makes most money, regardless of the spirit of the regulation.

Whilst this may be commercial common sense from the MNOs' point-of-view, it actively hinders the growth of competition in the EU. Court proceedings add cost and delay, and prevent customers from getting a fairer deal more quickly. Disputes of this nature are time-sensitive, and the Commission should take a firm line very quickly if it should find evidence of such conduct in the future.

Another area also needing to be carefully addressed by the Commission is SMS rates. SMS services are highly profitable, with costs being negligible, yet there is evidence that some MNOs are even seeking to increase SMS rates. This is unjustified and must be stopped.

A further sensitive issue is GSM Gateway Services, which the Commission addresses in the 13th Progress report. Indeed, GSM Gateways provide an arbitrage service as a direct consequence of the fact that fixed-to-mobile termination rates are too high. Were this not so then they could not exist. Despite Commission advice to the ERG that a general negative presumption should not be taken, and even Vice President Verheugen's support, INTUG note that in some Member States, the NRA supports MNOs in blocking their use. In the fixed world, carrier pre-selection is routine, yet in the mobile market such a solution is claimed to be catastrophic – just as the fixed networks used to claim when they were exposed to competition.

Mobile termination rates have been far too high for far too long. There is a pressing need for more unfettered competition in services provided over mobile networks, as the above examples illustrate, yet not enough is being done. At the moment, the network operators retain tight control over what is permitted and what is not, and mobile termination rates at such high levels prove that competition is being stifled.

INTUG notes that some MNOs moved from per second to per pulse billing in response to the roaming charge caps, in order to recoup revenue, actually resulting in real rates being higher for some traffic patterns. Such behaviour has not existed in the fixed market in most Member States for many years.

Over time, cheaper multi-frequency agile wireless devices, more/new operators offering mobility via wireless using the Digital Dividend and other liberalised spectrum, as well as Ultra Wideband systems, will all help to increase competition for nomadic service delivery, and spectrum will have more in common with a one hundred lane Motorway than a chronically congested lane – which is today's received wisdom.

One of the great benefits of Commission involvement is that it can avoid the "silo mentality" that exists in some Member States (the tendency to look at one issue at a time without thought being given to the effects that a decision in one sector has on others). A converging world demands converged and "joined-up" thinking.

In this consultation, it is immediately clear that the issue is bigger than just termination rates, they are just one part of the problem. Only in conjunction with wider and more extensive actions can the goals set in this consultation be achieved, and INTUG believes that the Commission is ideally positioned to champion the business user and consumer interest swiftly and successively.

Appendix – The Importance of Monitoring Retail Tariffs

INTUG recommends close analysis of retail tariffs offered to customers.

If an Operator is not selling at below cost (predatory pricing which would raise issues of antitrust), then tariffs must generate profits, however small. One example is the analysis of some tariffs of Operator “3” (Hutchinson Whampoa Group) in Italy for data transmission via the mobile network.

Users having a pre-paid SIM card and a terminal acting as a modem (UMTS HSDPA) can activate two options: “Naviga 7” or “Naviga 30”.

- “Naviga 7” allows a data transmission up to 100 MB per day (with no time limits) at 3.00 Euro per 7 days.
- “Naviga 30” allows a data transmission up to 50 MB per day (with no time limits) at 9.00 Euro per 30 days.

Both options can be automatically or manually renewed by the user.

Options are valid only under 3’s network coverage, but in Italy, 3 has a roaming agreement with Telecom Italia Mobile and roaming is automatic. Data transmission done using the Telecom Italia Mobile (“TIM”) network (GSM GPRS or EDGE only for 3's customers) costs 1.00 Euro per MB plus a set-up charge of 0,15 Euro.

There are no special conditions for the service duration save that the available credit is sufficient for automatic renewal. The cost per MB for the “Naviga 7” option is 0.4 Eurocent (1,7 Eurocent for the “Naviga 30” option). This shows that a profitable service offering for a mobile Operator is possible at a cost lower than 0.4 Eurocent per MB (INTUG suspects also at a much lower cost), and this kind of analytical approach could be applied more widely as a useful way to monitor how cost-orientated certain tariff offerings really are.

Another example of this logic in action would be GSM Gateways, where the MNO offers a tariff for “on-net” calls which is below the interconnect rate.