ARCEP's CONSULTATION ON MOBILE CALL TERMINATION

This paper sets out the response of the **3** Group businesses in Europe to ARCEP's consultation on mobile termination charges. Although the consultation concerns the regulation of termination charges in metropolitan France, it raises wider policy questions concerning termination rates, which are relevant to the entire mobile sector in Europe. For this reason the **3** Group is responding, in particular, to the issues identified in chapter 4 of the consultation.

In summary, the **3** Group believes that regulators should continue to bring termination rates down, ultimately to the point where there are no longer any termination payments between similarly placed network operators. The first step in this process would be to require immediate and sizeable reductions in termination charges. The **3** Group recognizes that getting to an end point of zero termination payments between operators may take time to implement and in the meantime regulation of termination charges should address the competition problems identified in the consultation. During the transition, it will often be necessary to have asymmetric termination rates to reflect the position of later market entrants.

The **3** Group is part of the Hutchison Whampoa Limited telecommunications division, operating 3G mobile telecommunications networks under the **3** brand in 6 EU Member States: Austria, Denmark, Ireland, Italy, Sweden and the UK. In just 3 years the **3** Group has spent over €19 billion acquiring licences and rolling out its mobile broadband networks in these countries.[1]

Termination charges distort competition

Termination charges above marginal cost can distort competition for the following reasons.

1. Termination charges above short run marginal cost benefit larger operators

Even where subject to market review or dispute resolution, termination charges in the EU are much greater than the marginal cost of providing termination. Therefore, termination charges provide a contribution to overheads and profit. The size of this contribution is determined by the regulator.

Given that termination charges are levied on each minute, the more minutes an operator has the larger the contribution it is granted by the regulator. Even if the network costs and the level of termination charges are equal for all operators, larger operators will derive a larger contribution to overheads and profit. This distorts competition in retail markets allowing larger operators, simply because of their size, to use the regulated payments to compete in retail markets more aggressively.

Above marginal cost per minute pricing also distorts consumers purchasing decisions.

Ultimately the only way of avoiding this distortion will be to set termination charges at, or even below, short run marginal cost.

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1 In addition, Hutchison Whampoa Limited operates 3G networks in Australia, Israel and Hong Kong and has a licence in Norway.

2. Termination charges support anti-competitive on-net/ off-net pricing strategies

The **3** Group agrees with ARCEP's conclusion that termination charges both enable and encourage larger operators to exploit network effects. This principally benefits large operators. The larger an operator's customer base, the more powerful are relevant network effects, since it offers more on-net call opportunities. A large operator can set low on-net call charges, thus making its network attractive. A small operator can also offer low on-net call charges, but since it offers fewer on-net calling opportunities, the offer is less attractive. The smaller operator is forced to price its off-net calls against the larger operator's on-net offer – with above marginal cost wholesale prices this creates a barrier to growth for new entrants.

Termination charges make it possible for a large operator to set on-net call charges that small operators cannot match (or cannot match profitably). Where the on-net call charge is below the termination charge, other operators cannot match the on-net price.

In fact, it is not necessary for the large network to differentiate its on-net and off-net prices. It can set a single low price below the level of termination charges in the knowledge that it pays the termination charge in far fewer instances.

Strategies that exploit the network effect for competitive advantage are only possible if there are above marginal cost termination charges set by the regulator. Lowering or removing termination charges removes the possibility for this competitive distortion. It is notable that ARCEP has observed an increase in on-net offers since the end of the bill and keep regime between mobile operators.

3. Termination charges often lead to a transfer of funds from one operator to another

On-net pricing strategies have a further distortionary effect on competition on the retail market. They lead to the large operator receiving more incoming calls than it sends. This is for two reasons. First, its own on-net pricing discourages calls to other networks. Second, smaller networks must respond by offering low prices for calls to all networks (since low on-net prices are not sufficiently attractive in themselves) and this encourages off-net calls. These factors put interconnection traffic out of balance with the result that small operators make net payments to large operators. This gives a perverse situation whereby small operators are financing their larger rivals as a result of regulatory intervention to promote competition. It is to be noted that the price caps imposed on larger operators have also, in practice, been price floors – it has not been possible to negotiate a lower price than the price cap.

4. Termination charges keep retail prices high and prevent the emergence of unlimited calls offers

Termination charges are a direct cost on every call that terminates outside of an operator's own network. This acts as a floor on retail prices. Furthermore, termination charges prevent the emergence of unlimited calls offers or offers with very large amounts of bundled minutes. This is because large bundled minutes give rise to a risk that termination payments to other operators exceed the revenue from the tariff package. International comparisons show that countries which have zero or very low termination rates have lower average retail prices per minute and higher mobile usage.

Where mobile operators compete directly, the strategic incentives identified above to charge different retail prices for on- and off-net calls, means that high termination charges reduce overall consumer benefits. Recent economic literature suggests, therefore, that, where there are externalities, it is beneficial to have very low termination rates between direct competitors.

Solution to the identified competition distortions

For all of the above reasons the **3** Group has concluded that regulators should be implementing sharp reductions in termination charges. Much lower termination rates will alleviate the competition problems identified above.

Ultimately, the **3** Group believes that regulators should move towards a system where there are no longer any termination payments between operators who are similarly situated in terms of network investment. This would remove the identified competition problems. It would also remove the need for routine regulatory intervention in the mobile sector, and so pave the way for the removal of all ex-ante regulation from the sector.

In the transition to a system of zero termination payments, the identified competition problems remain. During that transition, the appropriate way to alleviate those competition problems is to set asymmetric termination charges that allow later entrant operators to compete on a level playing field.

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