Fixed to Mobile Termination:

Topic 1: ***Should the Commission continue to regulate domestic GSM and CDMA origination and termination services?***

Presented to: ACCC Public Forum
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The Numbers: ***Termination Rates Are Well Above Cost***

Cost Estimates and Mobile Termination Proxy Indicators in Australian cpm			
	Australian cents pm Average	Peak	Off-Peak
Weighting		1.15	0.62
Belgium (Proximus) Estimate (^)	6.34		
US – Sprint estimate New York	7.85		
US – Sprint estimate California	10.08		
US – Sprint estimate Florida	13.30		
Spain – Average on-net mobile to mobile *	10.13	12.29	6.13
Belgium – Proximus on-net mobile to mobile *	10.87	12.61	7.67
UK – Analysys LRIC + EPMU **	11.92		
UK – average on-net mobile to mobile*	13.02	14.28	10.70
UK – MCI's MVPN with Vodafone	14.42	15.69	11.99
Australia – average fixed to mobile	24.00		

Table Notes:

^ This is a simple estimate of Proximus' costs prepared by Telenet in Belgium using publicly available data in the context of the consultation by the National Regulator on mobile termination rates in 2001.

* Rate shown is half of the total mobile-mobile rate for comparison with termination

** UK: Analysys Consultants model developed for OFTEL, 2001. Includes common costs on an Equi-Proportionate Markup (EPMU) basis

The Impact: *Higher Retail Rates, Reduced Competition and Dampened Demand*

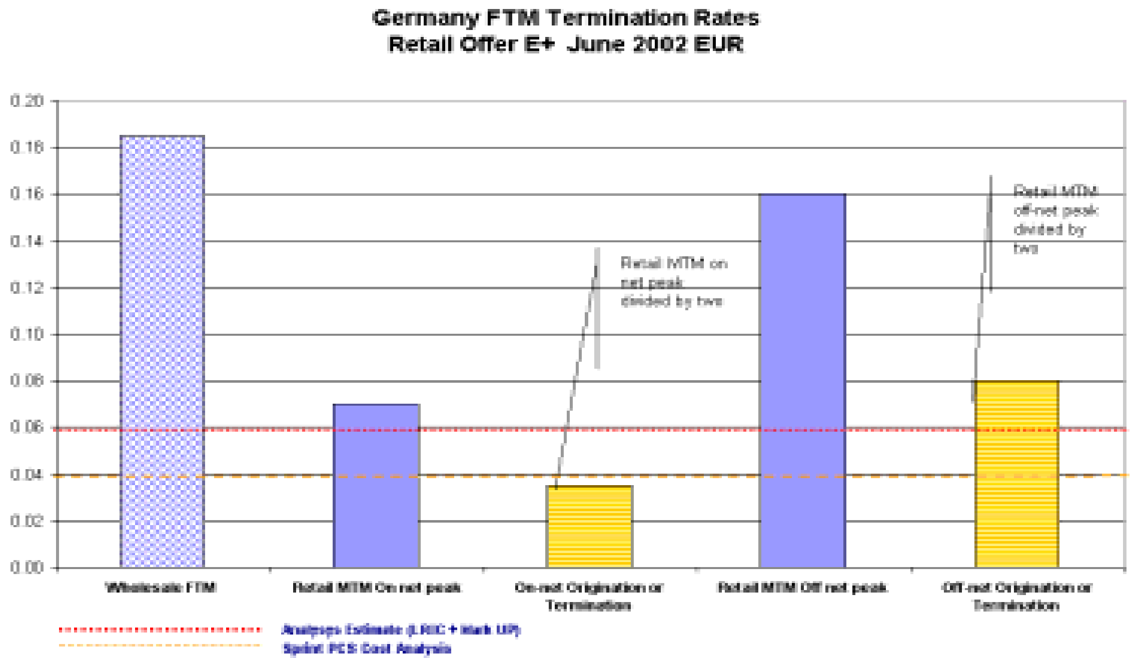
- **Direct impact to end users: High termination rates translate to high retail rates for fixed-to-mobile termination. Businesses suffer, residents suffer, as does Australia's national competitiveness**

- **Competitive impact: mobile operators arbitrage their own excessive rates. This excludes fixed operators from certain parts of the market. Competition flounders.**

- **Dampens demand: consumers make fewer fixed-to-mobile calls and talk for a shorter period of time**

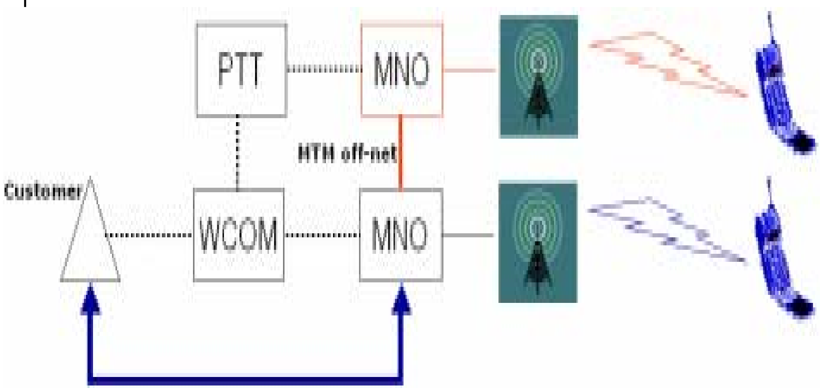
Note: These examples *are intensified* as mobile penetration rates increase

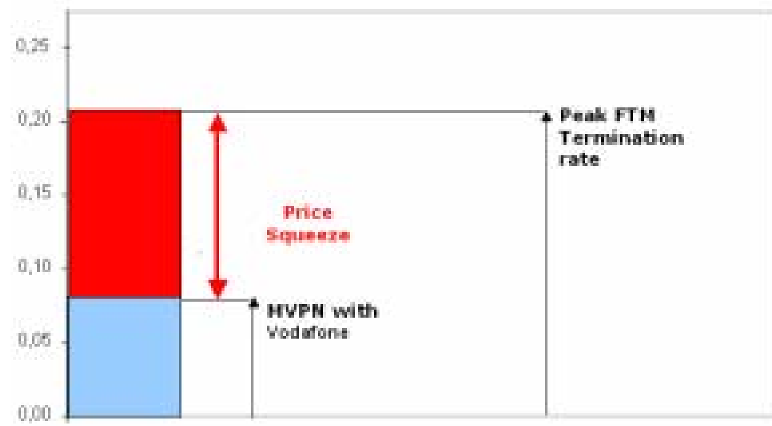
Competition Foreclosed: *Fertile Ground for Price Squeezes*



- **The FNO/MNO raises the price of inputs charged to competitors while enjoying lower costs for its own use of the input**
- **Vertically integrated FNO/MNOs can charge prices for retail FTM that are close to, or in some cases below, the termination rate**

Competition Foreclosed (con't): ***The Mobile Virtual Private Network Price Squeeze***





- **MNOs price squeeze FNOs by offering retail FTM termination at rates below wholesale FTM termination rates.**
- **Fixed Operators are unable to compete with MNOs who avoid the FTM termination costs.**

The Three Sub-issues for this Panel

Do mobile carriers have market power with respect to terminating calls on their networks, or is termination one service provided by mobile operators as part of a broader cluster of mobile telephony services ? [the MNO argument: the termination segment cannot be considered in isolation]

- This is “the Germany argument.”

- It is a flawed argument for an elementary reason: *The termination segment must be viewed in isolation (and not part of a bundle) because when you take out a mobile subscription you don’t buy termination. <u>Other people buy it, i.e., competitive operators, and for them it is very much an isolated product</u>*

- The related argument (also made in Germany) is the “altruist” and “closed user-group” argument -- i.e. that mobile phone users care deeply about the termination segment as part of their service package, so that it can’t be viewed in isolation. This is also a flawed argument on an elemental level -

  - Fails the empirical test - vast majority of users are not altruists
  - Fails the “shopping with my Dad” test
  - Fails the advertising test

§ Should the Commission be concerned if the price of termination on mobile networks is in excess of its costs ?

- **<u>The benefits of cost-based</u>:** When an isolated bottleneck service (mobile termination) is regulated at cost-based rates at least three good things happen: (1) the mobile provider of the service is compensated fairly; (2) competition blossoms since the mobile provider cannot arbitrage its own excessive rates to foreclose competition; and (3) demand increases as fixed callers make more mobile calls for longer periods

- **<u>Ramsey pricing doesn't work</u>**: Nice theory. But no Regulator in the world has ever explicitly applied Ramsey pricing
  - The amount of information needed to attempt Ramsey price regulation is enormous
  - The theory could only work if the retail market were perfectly competitive

§ To what extent are network externalities relevant when considering the optimal price of mobile termination services?

- MNO argument: *It's good for all of us when more of us take up mobile phones. In a perfect world, perhaps a mobile phone user would pay a little bit extra to the mobile operator so that they can build out and attract more mobile phone users. Since this doesn't happen, the mobile operators argue, they should be able to collect super-normal profits another way and mobile termination is it.*

- This is flawed logic in two simple ways:
  - high termination rates enable a cross subsidy that kills competition
  - mobile penetration is already high (60 - 70%)

Conclusion - A Few Final Thoughts

- It’s a Serious Problem in Search of a Strong Remedy

- We know It, National Regulators Know It, And They (MNOs) Know It Too

- Europe and the U.S. Respect The ACCC’s Early Recognition Of The Issue ... And Are Following This Proceeding With Interest

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Appendix: Europe Summary Update

Country	F2M Latest Developments - Europe Update Circa End July 2003
Austria	In April 2003, two of the four Mobile Network Operators (MNO's) to reduce their rates in two steps (3.5% and 4.5 %, respectively).
Belgium	Mandated reduction for F2M of RPI-46% over 4 years for SMP operators retroactive to January 2001. Another reduction of RPI - 12% scheduled for July 2003 will be effective until September.
France	A 5% reduction in F2M rates for 2003. In addition, the Telecoms Ministry approved a modest 9% reduction in retail rates for F2M for FT for 2003, reducing downward pressure on prices.
Italy	TIM and Vodafone mandated to reduce their F2M rates by 14% effective June 2003.
Netherlands	The Dutch Competition Authority has started an investigation into excessive pricing of mobile termination. An investigation report is expected in August/September of this year. An Oral Hearing and a sanction decision will follow after the report.
UK	On 22 January, the Competition Commission issued its recommendation that all mobile operators reduce their call termination charges 15% by 25 July 2003 followed by three annual reductions of 14%. Three mobiles launched judicial review proceedings agains
EC - Inclusion Of Mobile Termination In The List Of Markets To Be Regulated Under The New Telecom Regulatory Framework:	In February 2003, the Commission adopted a recommendation listing the markets that National Regulatory Agencies (NRAs) must analyze in the context of the implementation of the new regulatory framework. This recommendation includes the provision of termination on individual mobile networks. This is a very important step as it gives NRAs the ability (legal obligation) to regulate all mobile operators. The recommendation also contains a strong political message. By singling out mobile termination as a market to be regulated, the Commission clearly indicates that the time of "light-touch" regulation for MNOs is over