



**The Mobile Challengers call for
a regulation that takes into account
the anticompetitive effect of larger operators' on-net
offers**

A position paper on the abuse made by large operators of the on-net
effect to lock in their customers

December 2007

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1. Introduction

Two types of calls can be distinguished on the mobile market: “on-net calls” and “off-net calls”. “**On-net calls**” are calls between customers belonging to the same network. In contrast, the term “**off-net calls**” has been commonly used to characterize traffic which crosses mobile network boundaries (i.e. calls between customers belonging to different networks).

On-net call prices are generally set substantially lower than prices for off-net calls. A consequence of this on-net/off-net pricing strategy is that it encourages on-net and discourages off-net calls. As a result, on-net offers are an incentive for subscribers:

- To stay on the operator's network and,
- To encourage friends and family to join the same network, in order to pay less to stay in touch.

This phenomenon has been termed a “**tariff mediated network effect**”.

Most of operators commercialize on-net offers in order to build communities of users and to develop such a “network effect”. However, **this pricing strategy has been used to great effect by larger operators² for many years** due to the fact that it gives an advantage to larger operators by enhancing the network externality effect and by attracting customers from smaller networks. By proposing very attractive on-net offers, larger operators attract customers from smaller operators, who wish to benefit from a larger on-net community.

As a consequence, larger operators use on-net offers **to effectively reinforce their position on the retail market and to increase barriers for last/new entrants.**

2. Larger operators' on-net offers produce anticompetitive effects

Larger operators systematically propose on-net offers.

These aggressive on-net offers are designed to retain existing customers and attract new ones. In fact, lower on-net rates create a **financial incentive for people to join or remain with a mobile network operator with a relatively large subscriber base**, because the number of a mobile network operator's subscribers positively affects the likelihood that a customer can use a cheaper calling opportunity. In this way, **it is a strategy that reinforces market power.**

The discouragement to join a Challenger's network is reinforced by high off-net charges of larger operators. As noted above the on-net/off-net pricing strategy not only makes on-net calls attractive but it also discourages off-net calls. A customer of a small network is likely to receive fewer calls because his calling circle is more likely to be off-net. Many studies have proved that customers place a value on receiving calls, and so the on-net/off-net strategy means they derive less value from a small network³.

In contrast, **the effect of such offers cannot be replicated to the same extent by Challengers.** In fact, Challengers' customers do not get the same benefit from on-net offers because they have a smaller number of on-net calling opportunities. So, it is not possible for Challengers to outweigh the early mover customer number advantage by just setting their on-net rates equal to or, in some cases, even lower than to those of larger operators. A rational consumer will note that lower on-net charges of Challengers cannot compensate for the larger number of more expensive off-net calls he/she will have to place due to the smaller subscriber base of Challengers.

Therefore, to a large extent, the only possibility for Challengers to grow their customer base and to overcome the on-net pricing barrier set by larger operators is to commercialize “**all network tariffs**” that are set equal or below the on-net pricing level of larger operators. Then, in some cases, to be competitive, smaller operators must set low prices for calls to all networks, which, in turn, means that

¹ Bouygues Telecom, Base, E-Plus, Wind, Hutchison 3G, Avea, Meteor and P4.

² Operators with a large share of subscribers in their domestic market.

³ The subscribers avoid choosing smaller networks (either as a churn or as a new subscription) by thinking that their close environment will not call them because of the high prices. High off-net prices of larger operators decrease number of calls that subscribers of smaller operators receive.

customers of smaller operators have no disincentive to make off-net calls and so smaller operators attract customers with high outgoing (that is, off-net) call volumes. In other words, customers of smaller operators are not constrained by a higher price level for making off-net calls as it is the case on the network of larger operators (low on-net tariffs imply high off-net tariffs).

It is for this reason that such “all network tariffs” tend to increase the volume of traffic to other network operators, thereby raising the Challengers’ interconnection costs. Because Challengers send more traffic to larger operators than they receive, this translates into **massive financial transfers** from Challengers to larger operators (through MTRs). In this case:

- **Challengers’ interconnection traffic and payments are imbalanced**, and
- **Challengers are unfairly required to subsidize larger operators**.

Given that such transfers will curtail the deployment of the Challenger’s financial resources, it will significantly constrain the Challenger’s capabilities to instigate competition in the market. **Hence, this further distorts competition in favor of larger operators.**

This network effect was understood by the **French National Regulatory Authority** (the ARCEP) in its last **MTR market analysis**. For this reason, ARCEP decided to apply asymmetric termination rates (a decision which received the support of the European Commission)⁴.

In the same way, most **economic studies** related to on-net/off-net offers focus on the tariff mediated network effect, particularly:

- On the impact of on-net pricing on competition (especially for Challengers);
- On the advantage of network size in acquiring new subscribers.

Indeed, there is a considerable body of research and economic analysis that points to the need to regulate on-net offers and ensure their impact does not hinder competition:

- TERA for Bouygues Telecom;
- LECG, TERA and Ryan Associates for Base;
- Dialog Consult for E-Plus;
- Armstrong and Wright.

The effect of on-net offers, when practiced by larger/dominant operators, cannot be replicated to the same extent by new entrants. This pricing strategy by its nature tends to reinforce market power of larger operators. It is thus self-evident that such behavior results in anti-competitive effects (barriers to churn, limitation of choice for consumers, impossibility for competitors to replicate such offers, entry barriers etc.).

3. All the “Challengers” who provide on-net offers sooner or later reach the same conclusion: it is not possible to outweigh the early mover advantage of larger operators by proposing on-net offers

The following scenarios outline the experience of challenger operators in proposing on-net tariffs to the marketplace:

a. Challengers as market leaders for on-net tariffs

All Challengers, who were the first to offer on-net tariffs in their respective national markets, have shared the **same experience**:

- The strategy proved initially successful in gaining subscribers to the challenger network;
- However, this initial success stopped (or has been curtailed) as larger operators responded with their own on-net tariffs;
- As a result of larger operators using on-net tariffs as a marketing tool, Challengers have begun to “suffer” from the network effect.

It happened in France for **Bouygues Telecom**: when the last entrant commercialized its on-net offer, it was initially successful. In fact, beginning of 2004, Bouygues Telecom had almost 1M contract customers on its “Millenium” plan, i.e. unlimited on-net calls during the weekends and every evening

⁴ Mobile Challengers welcome this approach and stress the need for the ERG to also give its backing to such a regulatory determination.

after 20:00 to 8:00. Then, Orange and SFR tried to freeze the market shares by enriching all their offers with unlimited on-net calls 24/7 to 3 preferred numbers. These offers, launched in 2004 and generalized in 2005, have been successful until today. Unable to duplicate those offers due to its smaller market share and the high level of MTRs, Bouygues Telecom has lost almost 50% of its contract customers (it had less than 500k on its “millenium” plan by the end of 2005).

From 2003 to 2006, **Base** was quite successful with its bundles of free on-net minutes in Belgium. However, some time after Base moved to free on-net minutes, its competitors copied these offers. Because they benefit more from the on-net effect due to their large customer base and they have more financial and distribution means to emphasize this network effect, the two other operators even go a step further in the number of free minutes that they give and in some cases they do not even ask a monthly fee for these offers. So, Base had to look for another “unique selling proposition”. This resulted in the Base Platinum and Base Gold offers, which are “any network” bundle offers.

This also proved the case for **E-Plus (operating in Germany)**.

b. Challengers responding to the competitors’ on-net offers

Even when Challengers provide on-net offers, they do not succeed in competing with larger operators. Each time, the conclusion is the same: due to a large customer base and the network effect this creates, **larger operators are better placed to provide on-net offers and Challengers are unable to effectively compete against this pricing strategy and to react commercially** with the provision of this kind of offers⁵.

In some cases, the only competitive response for Challengers is to commercialize “**all network tariffs**”. Most of **economic studies** related to on-net/off-net offers stress this point: to compete against larger operators’ on-net offers, Challengers have to set their off-net rates at the same level as the on-net prices charged by larger operators (which may be below the level of MTRs).

In France, **Bouygues Telecom** had no choice: to face larger operators’ on-net offers, the last entrant was compelled to commercialize such offers as “**NEO**” - unlimited calls to **all networks** from 20:00 to 24:00 every evening and weekends. As a result of this pricing strategy, Bouygues Telecom incurred **transfers of more than 400M€ interconnect charges in two years**.

Meteor has also moved increasingly towards **all network tariffs**. As explained by Meteor, to face competitive on-net offers from larger operators and as an effort to grow the Meteor base, Meteor has expanded tariff plans to cover all national mobile networks.

Because dominant operators offered free on-net minutes at a massive scale, **Base** had to look for another offer to differentiate itself: in 2007, Base launched its Base Platinum and Gold offers, which are “**any network**” offers.

4. The number of litigation cases has grown recently on this matter

- In July 2004, **Bouygues Telecom Caraïbe** lodged a complaint before the **French Competition Authority** against Orange Caraïbe’s on-net offers. In December 2004, Bouygues Telecom Caraïbe obtained conservatory measures against Orange Caraïbe’s on-net offers. The French Competition Authority ruled that Orange Caraïbe’s on-net offers were abusive, since the difference in tariffs between on-net calls and off-net calls exceeded the difference of termination rates applicable for each of these calls.
- In October 2006, **Bouygues Telecom** registered a complaint against the on-net offers of Orange and SFR before the **French Competition Authority**. This complaint is still under investigation by the French Competition Authority.
- In 2003, **Base** lodged a complaint before the **Commercial Court** on the basis of the anticompetitive effects of Proximus’ on-net offers. Base stress especially that the difference in tariffs between on-net

⁵ Larger operators are able to sustain differences in their on-net and off-net prices because of high (above cost) mobile termination rates. Challenger networks have to pay these high MTRs for all off-net calls, while incumbents are able to undercut the termination rates for on-net calls.

calls and off-net calls exceeded the difference of termination rates applicable for each of these calls. In May 2007, the Court ruled that (a) it is undeniable that there is a network effect, but an expert has to examine whether this was abused and (b) the on-net rates may constitute a price squeeze. An expert was appointed and has 8 months to examine this.

- At the end of 2005, **Base** launched a complaint with the **Belgian Competition Council** against the price squeeze practices of Proximus in the corporate market. Although the offers made by Proximus are offers to any network, Proximus can only make these offers (which are below its own termination rates and certainly below the termination rates of the other mobile operators) because they know that most of the traffic will remain on their own network (because of their large market share). This complaint leads the Competition Council to raid the offices of Proximus in January 2006.
- As part of its decision on market 16, the **BIPT** (the Belgian regulator) imposed an “internal non-discrimination obligation” upon the two competitors of **Base**, Proximus and Mobistar. This obligation was imposed upon them and not upon Base specifically in order to overcome the on-net issue.
- **Avea** has suffered quite much from the on-net/off-net pricing differentiation. Before 2001, there were only two operators in the Turkish GSM market. However, when the third operator entered the market, the interconnection rates between the early entrants have suddenly been increased to 20 USD cents and dominant operator also started to offer its first on-net tariffs.

Avea complained before the **National Regulatory Authority** and the **Competition Authority** in order to:

- Limit the opportunity of larger operators to provide on-net offers below a certain level;
- Prevent larger operators from applying excessive off-net tariffs.

In October 2007, **Turkish Regulatory Authority** ruled that:

- Turkcell (the dominant operator with 60 % market share) is not allowed to charge an on-net rate less than its termination rate, neither in its normal tariffs nor in the discounted ones.
- Off-net tariffs in general packages will be capped.

On-net offers objectively favor operators with larger market shares and create anticompetitive effects on most of national markets. Furthermore, the number of litigation cases has grown recently in Europe on this matter.

As the issue exists in several Member States and to avoid inconsistencies between NRA’s decisions, this matter should not only be dealt with at a national level. In fact, a minimum level of harmonization is needed in order to:

- **Ensure the application of consistent regulation;**
- **Develop the European internal market.**

This is the reason why Challengers consider that:

- **On-net offers raise a pan-European issue and,**
- **The subject requires to be urgently dealt with at a European level by the Commission.**