APPENDIX 6.1

(referred to in paragraphs 2.436, 6.54 and 6.67)

Cellnet: general comments on possible remedies, and proposals for a possible price tracker index (extract from letter to the MMC of 25 September 1998)

Criteria

Before setting out details of any particular remedy, certain criteria need to be established by which to judge remedies for mobile termination rates against each other. In Cellnet's view, these criteria are:

i. *Proportionate:* the scope and scale of the remedy should fit the scale of the public interest finding

ii. *Non-utility:* the remedy should be narrower and less onerous than the scale of regulation imposed on utilities or static monopolies

iii. *Market-led:* the remedy should move the industry to a position consistent with that achievable by competition under prevailing and possible future economic and conditions

iv. *Specific*: the remedy should not leave discretion to the DGT

v. *Inviolate:* the remedy should not be manipulable by any player in the industry

vi. *Transparent:* the remedy should be understandable to the industry, the regulator and the analyst

vii. *Observable:* the remedy should be based on observable measures

viii. *MNP:* the remedy should not interfere with the implementation of Mobile Number Portability

In addition, the remedy will, by the nature of the complexity of the industry and issues being considered in this inquiry, also have to satisfy certain other constraints:

a) *Scrutiny:* to enable the DGT’s consultation to result in implementable proposals, the remedy will have to stand the scrutiny of the community of competition economists and lawyers

b) *EU:* although not directly part of the reference, the move towards standardisation of regulation of EU telecommunications means that, to be credible, the remedy will need to be capable of translation into other countries’ regimes

c) *Dynamic:* the remedy will require a methodology that is built on an economic model of a dynamic industry, not a traditional static view of utilities and regulation

d) *Groundbreaking:* the methodology—how to regulate a growing, competitive industry that has allegedly monopolistic aspects—will necessarily be groundbreaking

e) *All players:* if a remedy is deemed necessary, then, by definition, inbound calls to Orange and One2One also cannot be exposed to sufficient competitive pressures. Any remedies recommended by the MMC and implemented by the DGT would therefore have to cover Orange and One2One as well.

Having set out the criteria to be met, any price remedy has two elements: setting the initial ceiling rate, P_0, and setting any future changes to that ceiling. Cellnet views these as two separate issues.

Setting P_0

Cellnet believes that its submissions, and those it has commissioned from other experts, show that termination rates are set by reference to competitive forces. Furthermore, inbound and outbound retail prices are, and have fallen, roughly in line. Moreover, Cellnet's termination rates are fair and reasonable in relation to the MMC's own cost allocation model.

Thus Cellnet's proposal would be to set P_0 at 14.8 ppm until 31st July 1999.

Setting the pricetracker

Cellnet's proposal is set out in detail below:

New termination rates are implemented each year on 1st October. The percentage change from the previous year is based on the difference between the network operators' total annual outbound revenue per minute carried, calculated from 1st April to 31st March in each of the two most recent years. That is, net industry outgoing revenue divided by industry total outbound minutes (ie from subscribing customers).

"Net revenue" is used to ensure the revenue is that due to the network operators, not the service providers.

"Outgoing revenue" is defined as connections, plus subscriptions plus revenue from all calls billed to the subscriber.

"Subscriber" is the person with the SIM card (thus includes prepay customers).

Mathematically, the tracker works as per the example below:

If, 0(t–2) is outbound revenue per minute carried to 31 March 1998
0(t–1) is outbound revenue per minute carried to 31 March 1999
I(t–1) is the average termination rate ceiling set for the year to 30 September 1999,

then the average termination rate ceiling for 1 October 1999 to 30 September 2000 is I(t), where.

$$I(t) = I(t-1) * \{0(t-1) / 0(t-2)\}$$

Implementation on 1st October allows time to, among other things:

- calculate and validate the figures
- confirm the time of day rates
- confirm the associated BT retail prices and gain OFTEL approval
- allow other originating operators to revise their retail prices and change their networks' billing systems (NB *all* operators, not just BT)
- agree amended interconnect contracts
- change international accounting rates, if appropriate
- communicate the price changes to callers, via their provider of service, and to mobile subscribing customers, via Service Providers.

Note that the above points are also relevant to the calculation and implementation of any form of indexed price, be it cost-based or price-track based.

Other points to note:

- For simplicity, no allowance is made for the further "net" effect of payments to other operators (OLOs) for terminating calls on their networks, nor for any sophisticated allocation of different elements of the subscriber's package between inbound and outbound services. Given that what matters is the difference from year-to-year, the incremental effect in the tracker of including these effects would be small anyway.

- The actual inbound rates could be lower than those set by the formula, ie the formula is a price ceiling.

- A "correction factor" could also be applied to I(t) if I(t–1) was found to over- or under-shoot the required formula that had been set for it.

- Day/evening/weekend prices would be calculated by reference to the BT tariff gradient.

- Prices for 1st August 1999 to 30th September 1999 would be calculated using RPI–6 deflation, as per the CWC contract with Cellnet, applied to the termination rates charged to all interconnecting operators.

Advantages of the pricetracker over cost indexation

- It uses a competitive benchmark, so that the benefits from the competitive side of the mobile industry are passed directly to consumers in what would have been judged to be the less competitive side.

- Competition is intensifying further. This will continue to push down outbound prices and so will drive further efficiencies. The tracking linkage gives an automatic readover on to the price of inbound calls.

- It does not put the MMC and DGT in the impossible position of second-guessing which of a huge range of scenarios of growth (or lack of it) will prevail in a dynamic industry. The effects of any inaccurate forecasts, which would be inevitable in such an uncertain industry, could be extremely damaging to the industry, the consumer and the regulator.

- It uses an industry average, both of revenue and of minutes, so any individual player's actions are diluted by a factor of four, thus minimising the chances of manipulation.

- It maintains the linkage between outbound and inbound prices, so will still be relevant if the industry achieves very high penetration rapidly—which can only be done by steep price declines.

- Today's inbound prices are competitively determined, reflective of costs and in line with outbound prices. The start value is therefore clear. The continued linkage maintains a self-regulating proportionality of the remedy versus the public interest issue. The effect of the linkage also ensures that there is no artificial "spillover" of the remedy on to other aspects of the mobile operators' business. Cost indexation, if wrong, would have knock-on revenue and cost implications for each operator.

- It does not rely on estimation of the costs at one point in time of one particular operator, which in addition would not be transparent to the other three operators, and so does not distort the structure and competitive outcome of the whole industry.

- It does not rely on detailed and lengthy examination of business plans by the regulator. It is therefore less intrusive than other forms of cost-based indexation.

- It builds on data that is already published by Oftel, so does not require much extra data definition or data gathering.

- It uses data that is transparent, straightforward and regularly updated. This will give confidence to consumers, the industry and Oftel.

- It maintains an objective way of setting a single set of rates for calls to all four players, as required for Mobile Number Portability.

- It takes best practice from fixed regulation (ie focus regulation where it is needed and mimic as closely as possible the workings of competition) and extends it into a new groundbreaking dimension (an industry with four players, no incumbents and huge growth possibilities).

- It applies a dynamic economic model to the regulatory framework. In addition, the principles are simple and generic, so could be applied to other countries' mobile industries.

Cellnet therefore believes that, if the MMC were to conclude that future price regulation is needed, then the pricetracker is the "least bad" solution. However, in Cellnet's view, regulation is not needed and, in whatever form it might be introduced, regulation would be inferior to competition as a means of securing future inbound price reductions.

Source: Cellnet.