MEMO/08/438

Brussels, 26 June 2008

Termination rates: Questions and Answers

What are termination rates?

When a phone customer phones someone who belongs to a different network, that network charges the customer's network for connecting and 'terminating' the call. In other words, termination rates are the wholesale tariffs charged by the operator of a customer receiving a phone call to the operator of the caller's network. As part of the cost of a call between customers of different network operators, termination rates are included in everyone's phone bill and therefore eventually paid by the calling consumer.

Are there termination rates for both fixed and for mobile calls?

Termination rates are applied by both fixed and mobile operators for connecting calls on their networks. Mobile termination rates are in general much higher today than fixed termination rates. This disparity is greater than is justified by the differences in the underlying costs, networks or national characteristics. When exchanging traffic, fixed operators pay on average 9 times more to the mobile operator than the mobile operator pays to the fixed operators leading to an indirect subsidy from fixed to mobile consumers. Today the biggest contributors to mobile revenues are fixed line subscribers phoning mobile numbers.

Why are termination rates regulated?

Termination rates are currently regulated in the EU countries by the national telecoms regulators to avoid distortions of competition. The main competition concern, common to both fixed and mobile termination markets, is excessive pricing. In the EU, the cost of call termination is currently borne entirely by the network and customer that originates the call (i.e., the calling party) and the called party is not billed for incoming calls. This is known as the "Calling Party Pays" (CPP) principle, and leads to a situation whereby the terminating operator can charge excessive prices to other operators and their customers for connecting calls to its network, with its own subscribers being generally unaffected by the level of those charges. The regulation of termination rates therefore addresses the risk of excessive pricing by ensuring that the prices reflect the actual costs of terminating the call.

Who regulates termination rates?

The regulation of termination rates in each Member State is the responsibility of the national regulatory authority. In accordance with the EU's Telecom Rules, where a national regulator determines that a relevant market is not effectively competitive, it shall identify undertakings with significant market power and impose appropriate regulatory obligations. (MEMO/07/457).

Are there EU rules on how to regulate termination rates?

The Commission has expressed its views on the regulation of call termination markets in the context of several notifications received from national regulators under the Community consultation mechanism (the so-called Article 7 procedure). In its responses to regulators under this procedure, the Commission has noted the importance of regulating termination rates based on the costs of an efficient operator. This is to provide operators with incentives to become efficient, to ensure a level playing field amongst different operators, and to bring benefits to consumers, including lower prices.

Europe has a strong Telecoms sector thanks to the current framework of Telecoms Rules (of 2002). This said, the sector will fail to reach its full potential if the Commission does not remove remaining barriers to the Single European Telecoms Market – one of them being inconsistent regulation of termination rates (MEMO/08/167).

Why is the Commission now intervening?

While mobile termination rates are on a downward trend as a result of regulatory intervention in the European Union, they remain high – almost 9 times the equivalent fixed rate – and are set at disparate levels across different Member States. This is the result of inconsistent and divergent approaches to the regulation of termination rates, which hampers the consolidation of the internal market and the realisation of consumer benefits from cross-border competition and services. Furthermore, inconsistent approaches to the regulation of fixed and mobile termination rates tilt the level playing field in favour of mobile networks and services to the detriment of fixed networks and their customers. In addition, allowing termination rates above an efficient level of cost can lead to higher retail tariffs for consumers. This is why the Commission has made it a priority to provide guidance and greater legal certainty to both operators and national regulatory authorities on an effective regulatory treatment of fixed and mobile termination rates in the EU.

For example in 2007, the French regulator ARCEP already decided to lower the wholesale *mobile* termination rates foreseen by the EU Telecom rules (IP/07/1333). The Italian regulator ACGOM also agreed to move to lower, symmetric termination rates for *fixed* alternative operators by 1 July 2010, but only after the Commission had intervened (IP/08/551). Symmetric termination rates means that the termination rates which the relevant phone operators are allowed to charge are the same.

In the Commission's view, how far should mobile termination rates go down?

The Commission’s draft Recommendation first and foremost aims at greater consistency and more effective regulation of termination rates. The objective is not to regulate down to a particular level, nor to adopt a 'one-size-fits-all' approach. At the same time, there still appears to be scope for relatively significant reductions of mobile termination rates from current levels. For example, at the end of 2007 the average mobile termination rate was 9 times higher than the average fixed termination rate. Regulating termination rates on the basis of efficient costs should result in substantial reductions over the next three years, possibly leading to reductions of around 70%.

What will be the potential effects of the Commission's intervention for competition?

A common approach to the regulation of termination rates in the EU will provide greater legal certainty to operators and should help promote cross-border investment. Regulating termination rates based on the costs of an efficient operator should also reduce cross subsidies from fixed to mobile operators and minimise the financial impact of traffic imbalances between smaller and larger operators.

Mobile termination rates that are set at an efficient cost-oriented level lead to a level playing field for operators and provide appropriate investment incentives while still allowing operators to cover the cost of terminating calls.

How will consumers benefit from the Commission's intervention?

It can be expected that regulating termination rates on the basis of the costs of an efficient operator would ultimately result in lower phone bills for consumers. Enhanced competition between operators should also help to bring down retail prices and encourage important network and service innovations, such as fibre roll-out and the development of bundled offerings or converged services. More competition and wider choice of services for the consumers are the essence of the new EU Telecoms Rules proposal (IP/07/1677).

Are there also termination rates on the US telecoms market?

In the US, mobile termination rates are generally much lower than in the EU. In general, operators are free to negotiate rates as long as the negotiated rate is symmetric (i.e. both operators charge each other the same termination rate for connecting calls from each other's customers). In addition, fixed incumbent operators are typically required to set cost-based termination rates. This system has led to: i) low termination rates being applied by incumbent fixed operators (typically less than one US cent per minute); and ii) zero termination rates frequently being set for traffic exchanged between mobile operators and new entrant fixed operators (i.e. "Bill and Keep" style arrangements).

Will lower mobile termination rates in the EU lead to "US style" phone charges?

The adoption of alternative business models for the exchange of termination traffic is ultimately a commercial decision for the operators. The draft Commission Recommendation does not preclude alternative mechanisms from evolving in the future to the extent that they are consistent with a competitive outcome and in the interests of consumers. However, given the current level of termination rates in the EU, particularly mobile termination rates, it is difficult to envisage operators moving to these alternative models at present. Reducing termination rates to the level of efficient costs is an important first step before other potential approaches may be introduced.

However, as noted earlier, under the current "Calling Party Pays" system in the EU, a situation arises whereby terminating network operators have the ability and incentives to charge excessive prices. Alternative mechanisms for the exchange of termination traffic, such as "Bill and Keep" or a system whereby part of the termination cost is recovered from the person receiving the call (i.e., "Receiving Party Pays"), can help address the situation created by the "Calling Party Pays" system, although there may be other considerations associated with their implementation.

Will the Commission proposal lead to a situation where consumers in Europe have to pay for receiving telephone calls?

As noted above, the choice of business model is ultimately a matter for the operators to decide. While it may not be excluded that a "Receiving Party Pays" system could emerge if operators decide to recover part of their termination cost directly from the called party, it is difficult to envisage such a situation emerging at present given the current level of termination rates in the EU. Regulating termination rates consistently and based on the costs of an efficient operator is a key objective of the draft Recommendation and a necessary first step before alternative approaches may be expected to evolve. Most importantly, whatever system evolves as a result of lower mobile termination rates, consumers in Europe will be substantially better off than today.

For further information, please contact: