January 18, 2005

Ms. Gloria Blue
Executive Secretary
Trade Policy Staff Committee
ATTN: Section 1377 Comments
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, DC 20508

RE: Slovenia - *Compliance with its WTO Obligations;*
Reply to AT&T - *mobile termination rates*

Dear Ms. Blue:

Pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. § 3106 ("Section 1377"), Western Wireless International ("WWI") hereby submits these reply comments in response to the request of the Office of the United States Trade Representative ("USTR") for comments regarding compliance with telecommunications trade agreements. WWI is a subsidiary of Western Wireless Corporation, one of the largest providers of rural wireless communications services in the United States. WWI, through various subsidiaries and operating entities, is licensed to provide mobile communications services to over 72 million people in eight countries, including Austria, Ireland, Slovenia, Bolivia, Ghana and Haiti. 1/ In this filing, WWI highlights for the USTR the anti-competitive barriers faced by WWI in Slovenia, and replies to earlier comments addressing the issue of foreign mobile termination rates.

Slovenia Fails to Satisfy WTO Obligations

Slovenia has been a member of the WTO since July 30, 1995. On May 1, 2004, Slovenia acceded to the European Union ("EU"), whose member states are subject to a schedule of specific commitments associated with the WTO Basic Telecommunications Agreement, including the Telecommunications Reference Paper ("Reference Paper").

1/ WWI also holds a minority investment in a mobile services provider in the Republic of Georgia. WWI previously held a minority interest in a mobile services provider in Cote d'Ivoire. However, service was suspended after the assets of that operating entity were expropriated in 2003. WWI has filed a $55 million expropriation claim against the Ivorian government.

WWI, through its subsidiary Western Wireless International d.o.o., entered the Slovenian mobile communications market in 2001, offering 1800 MHz GSM mobile communications services under the brand name "VEGA." WWI is one of the largest U.S. investors in Slovenia, and the only multinational company to invest more than $200 million in the last four years. After three years of operations, however, WWI has less than a 2% market share, with the incumbent, majority state-owned operator, Mobitel, retaining over three-quarters of the market. Another competitor, Simobil, an affiliate of Vodafone, has been unable to muster more than a 21% market share, despite an earlier market entry date (1999) and aggressive marketing with Vodafone's strong international brand name. Indeed, Mobitel has lost the *least* amount of market share among all incumbent mobile operators in the EU member states, as measured in the first four years after competition first appeared in a given market, 2/ and Mobitel still retains the highest market share of any mobile operator in the EU, by far.

Mobitel's ability to retain overwhelming market share results largely from its anti-competitive cross-subsidization of on-net calls by its high charges for off-net calls. For Mobitel subscribers on the carrier's four most popular calling plans, making a peak-period call to a WWI customer costs 2 to 14 times more than a call to another Mobitel subscriber. 3/ This large cost differential discourages Slovenians from signing up with WWI, as they know that Mobitel subscribers – *i.e.*, most of the country's wireless users – will be reluctant to call them due to the higher cost that will be incurred.

In a 2004 paper on Slovenian telecommunications reform ("*Reform White Paper*"), faculty at the University of Ljubljana's School of Economics agreed that the large price difference between on-net and off-net calling is one of the main causes of concentration in the mobile services market. 4/ The authors explained that on-net calls are being provided below cost, subsidized by high off-net charges. 5/ As laid out in detail in WWI's new draft Complaint (attached), it is clear that Mobitel is engaged in predatory pricing, given that its on-net rates cannot cover Mobitel's average variable costs attributable to those calls, and are not set to

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2/ All other EU mobile operators ranged between approximately 45% to 65% market share after four years' of competition, compared to Mobitel's 78%.

3/ WWI notes that this much higher cost cannot be attributed to WWI's mobile termination rates for calls originating on Mobitel's network. WWI and Mobile have symmetric termination charges.

4/ *See* N. Hrovatin *et al., Liberalisation and (De)Regulation of Slovenian Telecommunications Markets* (2004) at 6, 18 ("[F]or the user, the network that has the most users has the greatest value;" "In our opinion, the reasons for the concentrated market structure in the mobile telephony market lie in the late granting of GSM licenses to competing firms and the high price differences between on-net and off-net prices.").

5/ *Id*. at 13, 18.

maximize profits. 6/ This type of cross-subsidization, which has the effect of suppressing competition, is directly prohibited by Section 1 of the Reference Paper. 7/

Mobitel also relies on non-price barriers to prevent the churn of its customers to WWI. Its customer contracts carry unusually long terms of 24-36 months – longer than what is typically required to recover any subsidy related to handset provisioning. Customers replacing a handset have their contracts further extended by a similar period, resulting in contractual commitments of several years. Moreover, even after the expiration of a customer's contract, customers must pay to have their handsets unlocked to permit the use any non-Mobitel SIM card.

Mobitel's parent, Telekom Slovenije, has also engaged in anti-competitive practices adversely impacting WWI. In 2003, neither WWI nor Simobil was offered access to the national phonebook (and associated directory assistance listing) that is published by Telekom Slovenije, although Mobitel's customers had the option of being listed. In response to WWI's complaint, in 2004 Telekom Slovenije did offer to provide WWI with access to the directory, but at a commercially unreasonable rate of 12.5 Euro cents per number per month. WWI does not believe that Mobitel is required to pay such a fee for its customers. The Alternative Providers of Electronic Communications in Slovenia ("APECS") has asked the EU DG Information Society to investigate whether such activity represents discriminatory treatment or illegal state aid through the use of ownership connections.

Since the filing by WWI of a formal complaint in April 2003, 8/ Mobitel's pattern of anti-competitive behavior has repeatedly been brought to the attention of Slovenia's national telecommunications regulatory authority ("NRA") and national competition authority ("NCA") and the relevant government ministries, but no concrete actions have been taken by the government of Slovenia to curb such behavior. Indeed, despite the existence of the requisite legal authority, WWI is of the view that the Slovenian government has neither the will nor the means at the present time to thoroughly investigate and curb Mobitel's anti-competitive activity.

WWI's experience highlights the fact that Slovenia has failed to satisfy its obligation to establish a truly independent regulator. Under Section 5 of the Reference Paper, member states are to ensure that "the regulator is separate from, and not accountable to, any

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6/ *See* "Draft Vega Complaint Relating to the Anti-Competitive Behaviour of Mobitel, d.d." (Nov. 2004) at 19-25. In particular, the Draft Complaint builds on a concept of predatory pricing already established in the academic literature that focuses on two-tiered tariffs that are used to strengthen "network externalities" to discourage customer churn. *See id.* at 20 (citing work by Matthias Blonski).

7/ Section 1 states that "appropriate measures shall be maintained for the purpose of preventing suppliers . . . from engaging in or continuing anti-competitive practices." Section 1.2 clarifies that such anti-competitive practices includes in particular "engaging in anti-competitive cross-subsidization."

8/ WWI's complaint was based on sections 75 and 77 of Slovenia's Telecommunications Act.

supplier of basic telecommunications services. The decisions of and the procedures used by regulators shall be impartial with respect to all market participants."

The Slovenian government has a 62.5% controlling interest in Telekom Slovenije, the country's monopoly wireline provider which is the 100% owner of Mobitel. At the same time, however, the government appoints the head of the NRA. Moreover, the NRA is partially funded by the Ministry of Information Society, which can overrule decisions taken by the NRA. WWI believes that it is this clear conflict of interest that has kept the NRA from taking any meaningful action on WWI's complaint.

The lack of adequate due process and transparency also calls the NRA's impartiality into question. After WWI filed its complaint, the NRA did initiate a proceeding against Mobitel (as well as Simobil), although its focus on mobile termination rates was not responsive to WWI assertions relating to the on-net vs. off-net retail pricing differentials. WWI was forced to specifically request copies of all decisions related to the proceeding, given that the NRA concluded that WWI, even as complainant, was not a party to the proceeding. After Mobitel and Simobil made some minor changes to their tariffs, the NRA suspended the proceeding without assessing whether the changes addressed WWI's complaint (they did not). WWI filed a complaint against the suspension decision, which was rejected by the NRA on the basis that WWI was not a party to the proceeding. This decision was appealed by WWI to the the Ministry of Information Society which replied positively, giving WWI the right to appeal and urging the NRA to act. The response of the NRA was to ask WWI to justify again why it is a party. The NRA recently rendered another decision concluding that WWI is not a party to this proceeding. At this point, WWI has made multiple filings with the NRA to support its claim that it should be permitted to participate in the proceeding, in which decisions have been made that directly impact WWI's ability to compete in the marketplace.

WWI had hoped that accession to the EU would ensure that Slovenia would be required to give proper consideration to WWI complaints. Unfortunately, over eight months after accession, there has been no sign of real progress. Moreover, WWI has explained its experience in Slovenia to the EU's DG Competition and DG Information Society. With the exception of a few status contacts, however, WWI is aware of no DG Competition or DG Information Society involvement in this matter.

As Commerce Secretary Donald Evans stated in a letter to Slovenia's prime minister, "The difficulty being experienced by Western Wireless International/VEGA with Slovenia's regulatory system sends a negative message to potential investors and may adversely impact future U.S. investment in Slovenia." 9/ Equally significant, WWI's ongoing difficulties suggests that Slovenia has not yet learned to take seriously its WTO obligations, including those associated with its recent accession to the EU.

9/ Letter from Donald Evans, U.S. Commerce Secretary, to Anton Rop, Slovenian Prime Minister, Sept. 14, 2004 at 1.

Reply to AT&T Comments on Mobile Termination Rates

AT&T Corp. ("AT&T") and other parties filed initial comments in this proceeding to apprise the USTR of high fixed-to-mobile termination rates present in certain countries. In its comments, AT&T purported to have determined that the mobile termination cost ceiling for 65 countries should average no more than $0.083. 10/ Without commenting on whether any individual NRA is permitting excessively high fixed-to-mobile termination rates, WWI notes that determining mobile termination costs is an extremely complex undertaking which requires a significant amount of information about the competitive dynamics of a particular market. 11/ Developing a reasonably accurate cost study for dozens of foreign countries would be a massive undertaking. Moreover, such an undertaking would be nearly impossible for one regulatory agency (especially one with a limited ability to compel the submission of information concerning the costs of operators that operate wholly outside of its borders) to achieve. 12/ Accordingly, the task of developing cost studies relating to particular national markets should be left to the individual regulatory bodies in those markets.

It is important to recognize that the "excessive" mobile termination rates are not targeted at U.S. or other foreign originating carriers. Generally, the mobile termination rates paid by U.S. carriers are the same as those incurred by fixed carriers in the mobile operator's home country. 13/ It is not clear that WTO obligations would require regulators to mandate that international carriers be charged a lower termination rate than what is applicable to domestic carriers.

The various NRAs, prompted by consumer concerns and wireline carrier interests, have an adequate motivation to see that mobile termination rates are set at efficient levels. With regard to the European markets, which represent the bulk of WWI's operations, WWI believes

10/ *See* AT&T Section 1377 Comments (Dec. 17, 2004) at 2.

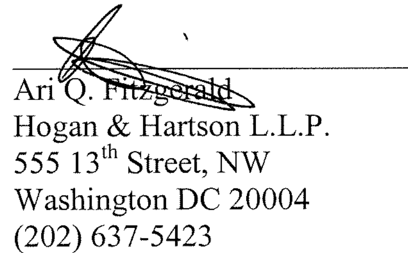
11/ *See* G. Houpis and T.M. Valletti, "Mobile termination: what is the 'right' charge?" (March 2004) at 1.

12/ WWI notes that, at the urging of several international long distance providers, the FCC has issued a notice of inquiry seeking comment on whether it should regulate foreign mobile termination rates. *See Effect of Foreign Mobile Termination Rates on U.S. Customers*, IB Docket No. 04-398, Notice of Inquiry, FCC 04-247 (rel. Oct. 26, 2004).

13/ In fact, the majority of the termination fees are paid by domestic carriers. WWI notes that data from its operations in Europe indicate that more than 97% of all traffic terminating on WWI's mobile networks originate in Europe.

that progress is being made in addressing these concerns. Where NRAs are not adequately pro-active, the European Commission has indicated and demonstrated its ability to intervene. 14/

Respectfully Submitted,



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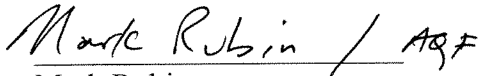

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January 18, 2005

14/ *See* Letter from Erkki Liikanen, European Commission to FCC Chairman Powell (Mar. 4, 2004) filed in IB Docket No. 02-324 (stating that the European Commission has launched infringement proceedings against those EU member states which did not adopt appropriate measures required by the new European framework for electronic networks within the designated timeframe).

- DRAFT -
November 2004

VEGA

COMPLAINT RELATING TO THE

ANTI-COMPETITIVE BEHAVIOUR OF

MOBITEL, d.d.

GIBSON, DUNN & CRUTCHER LLP

EXECUTIVE SUMMARY

Vega is the third mobile operator in Slovenia. While the Slovenian mobile sector has achieved significant penetration levels, reaching approximately 90% by the end of 2003,[1] Mobitel has, four years after the introduction of competition, retained over 78% of the market. [2]

Vega believes that Mobitel has structured its tariffs to ensure that its installed base of customers does not migrate to other mobile operators. By structuring the tariffs to provide a significant on-net/ off-net price differential (*e.g.,* between 2.0 and 2.5 for peak calls on the three most popular Mobitel tariff plans), Mobitel is both ensuring that communities of users currently using Mobitel's services do not migrate to other mobile operators and that such users encourage members of their 'community' using another network to migrate back to Mobitel.

Mobitel's retail tariff structures amount to the exclusionary exploitation of the network effects that it enjoys as the operator with a very large 'network' of users, through its installed base of customers. Its tariffs are discriminatory, display cross-subsidisation of on-net calls by off-net calls and entail predatory on-net pricing. Further, these pricing practices are not profit-maximising and, thereby, cannot have any competitive consequence other than one which is exclusionary. Mobitel's pricing strategy is designed to preserve its massively dominant market share. In addition, Mobitel engages in non-pricing behaviour that is both indicative of, and further strengthens, its exclusionary intent, through the imposition of contracts of excessive duration, SIM-locking and the leveraging of its monopoly position in the related directories market.

The European Commission's Competition Directorate is requested to investigate the claims set forth in this complaint because there is a clear Community interest in it doing so, *inter alia* because:

- both the Slovenian NRA and NCA are currently ill-equipped, both in terms of technical knowledge and resources to be able to thoroughly and appropriately appraise, in a timely manner, the alleged abuses by Mobitel;
- Vega has, to all practical intents and purposes, exhausted the avenues of investigation open under Slovenian law;
- it appears that the ownership stake retained by the Slovenian state in Mobitel severely compromises its ability and will to take appropriate action;
- the issues identified by Vega raise very important questions of precedential relevance to the whole territory of the enlarged European Union, and the mobile industry in particular;

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[1] Figures derived from operator subscriber numbers, as published on their websites.

[2] Figures derived from operator subscriber numbers, as published on their websites.

- the alleged conduct is not realistically susceptible to *ex ante* regulation when Slovenian implementation of the new electronic communications regulatory framework occurs;

- Vega's commercial position is such that it has no choice but to seek interim measures from the European Commission under Article 82 EC, in the absence of a similarly effective Slovenian avenue; and

- the legal standard for the adoption of interim measures is met.

Accordingly, Vega wishes to lodge this complaint under Article 82 of the EC Treaty to the European Commission. It believes that failure by the European Commission to act under Community law would be contrary to its obligations under the EC Treaty ('EC').

The European Commission is requested to take appropriate and proportionate measures to restore the market to the appropriate competitive equilibrium, namely to:

- require Mobitel's on-net and off-net tariffs to diverge only by an amount representing the differences in costs (where the cost of terminating on-net and off-net calls should be considered to be the reciprocal termination charge);
- require Mobitel's on-net tariffs to be set at a level that exceeds its mobile termination rate by an amount which covers the incremental network and retail costs of call origination; and
- render unenforceable those practices of Mobitel which raise switching costs that are contrary to European best practices and currently exist for Slovenian customers.

1. JURISDICTION

I.1. The Commission's Obligations

1.1 The Commission, entrusted by Article 85(1) EC[3] with the task of ensuring application of the principles laid down in Article 82 EC, is responsible for defining and implementing the orientation of Community competition policy.[4]

1.2 The Court of Justice has held that, in meeting its responsibility, the Commission is entitled to give differing degrees of priority to complaints in order to effectively define and implement Community competition policy, and cannot be compelled to commence proceedings or make a decision in relation to allegations relating to Article 82 EC Treaty.[5] However, the Court imposes a key limitation on the Commission's exercise of its prioritisation discretion, in that it 'may not regard as excluded in principle from its purview certain situations which come under the task entrusted to it by the Treaty'. The Commission must assess the seriousness of the alleged interference with competition and the persistence of its consequences.[6] In doing so, it must examine carefully the factual and legal particulars brought to its notice.

1.3 Article 83(2)(d) EC makes provision for Council regulations to define the functions of the Commission in applying Article 82. The EC Treaty does not expressly refer to the role of Member State authorities in relation to the implementation of Community competition policy (after the entry into force of Council regulations adopted from time to time).

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[3] Article 85(1) EC Treaty is a competition-specific manifestation of the broad duty under Article 211 EC Treaty to ensure that the 'provisions of the Treaty and the measures taken pursuant to it pursuant thereto are applied' and to exercise the powers 'conferred on it by the Council for the implementation of the rules laid down' by the Council.

[4] *See*, for example, *Masterfoods Ltd v HB Ice Cream Ltd* [2000] ECR I-11369 at para. 46; *Automec v Commission of the European Communities* [1992] ECR II-2223 at para. 73; *Ufex, DHL International and Service CRIE v Commission of the European Communications* [1999] ECR I-1341 at para. 88.

[5] Prior to Council Regulation 1/2003, the Commission exercised exclusive jurisdiction in relation to the grant of exemptions under Article 81(3) EC Treaty. In relation to such matters, the Commission did have a duty to make a decision in relation to an alleged infringement that was brought to its attention.

[6] *Ufex, DHL International and Service CRIE v Commission of the European Communications* [1999] ECR I-1341, at paras. 92 to 94.

I.2. Relationship Between the Commission and the Member States

1.4 Council Regulation 1/2003[7] makes provision for the role of Member State authorities in relation to the concurrent application of Articles 81 and 82 EC. In particular, Articles 5 and 6 of Council Regulation 1/2003 state that the respective competition authorities and national courts of the Member States shall have the power to apply Article 82 EC Treaty. Further, Article 3 requires the application of Article 82 EC in addition to the equivalent national competition laws. Recital 6 characterises the empowerment of Member State authorities as being driven by the need for effective application of the competition rules. However, Article 11(6) provides that initiation of proceedings by the Commission automatically relieves Member State competition authorities of their competence to apply Article 82 EC Treaty. Recital 17 states that this is essential for the consistent application of competition rules. Further, this approach reflects the underlying principle confirmed by the Court of Justice that the Commission's role under the EC Treaty is such that it cannot be bound by (*i.e.,* permit its jurisdiction to be supplanted by) a Member State decision.[8]

1.5 In addition, two Commission Notices shed further light on the manner in which the Commission (and the Member States' competition authorities) intend to 'manage' their concurrent Article 82 competences. The *Commission Notice on the handling of complaints by the Commission under Articles 81 and 82 of the EC Treaty* (2004/C 101/05) states, at paragraph 11, that the Commission intends to handle cases in relation to which it should act with a view to defining Community competition policy and/ or to ensure the coherent application of Articles 81 and 82 EC. The *Commission Notice on cooperation within the Network of Competition Authorities* (2004/C 101/03) articulates the underlying basis for the allocation of cases between the Commission and Member State competition authorities, referring to the 'full discretion' of each authority in deciding whether to investigate a case. Of particular relevance, paragraphs 7 and 15 indicate that cases should be reallocated, *where it is necessary for the effective protection of competition and of the Community interest*, to a single 'well placed' competition authority as quickly and efficiently as possible. The Commission is particularly 'well placed' if the Community interest requires the adoption of a Commission decision to develop Community competition policy when a new competition issue arises or to ensure effective enforcement.

1.6 Finally, Recital 17 of Council Regulation 1/2003 provides that the Commission should endeavour to initiate proceedings 'as soon as possible' where a Member State is already acting on a case. Paragraphs 16 and 18 of the *Commission Notice on cooperation within the Network of Competition Authorities* provide that case re-allocation issues should be

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[7] Council Regulation (EC) No 1/2003 of 16 December 2002 *on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.*

[8] *Masterfoods Ltd v HB Ice Cream Ltd* [2000] ECR I-11369 at paras. 48 and 49.

resolved within a period of two months from the data of the first information sent to a competition authority under Article 11 of Council Regulation 1/2003.

1.7 In this light, it is clear that the Commission is obliged to consider all complaints relating to infringements of Article 82 EC Treaty that are submitted to it. In doing so, it cannot dismiss any claim without fulfilling the tasks entrusted to it by the EC Treaty. Further, the Commission's duties under the EC Treaty cannot be abrogated merely because a Member State is purporting to consider a complaint. Further, it has become clear over the last 18 months that the Slovenian institutions are not able or equipped to take action in a relevant or appropriate timeframe.

1.8 The Commission's exercise of its discretion to exercise its jurisdiction must consider the nature and seriousness of the alleged interference with competition, the extent to which action relating to the alleged interference with competition will define competition policy in relation to a new issue and the extent to which action by the Commission is necessary to ensure effective and efficient enforcement.[9]

1.9 It is clear that Vega's complaint relates to conduct and important new issues that are relevant in, and should be consistently and coherently addressed across, all 25 Member States. As the Commission itself acknowledged on 14 October 2004, consideration of the appropriate treatment of on-net/ off-net pricing practices under EC competition rules is a matter of policy priority.[10] Further, the 18 months that have elapsed, without action, since Vega's complaints were initially filed with the Slovenian authorities indicate that enforcement in Slovenia will be neither effective nor efficient if the Commission does not exert jurisdiction.

I.3. Effect on Trade

1.10 As a final matter, Vega confirms that Mobitel's conduct does in fact have an effect on trade between Member States, as a result of its impact on both the entire Slovenian market and on roaming subscribers. Further, it is clear that this affect is significant, in light of Mobitel's shares on the various relevant product markets.

1.11 In closing, the Commission is requested to seize jurisdiction in this matter, and to adopt interim measures in the form requested in Section III of this Complaint. Failure by the Commission to act would seriously compromise Vega's directly enforceable rights under Article 82 EC.

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[9] *Masterfoods Ltd v HB Ice Cream Ltd* [2000] ECR I-11369 at para. 46; *Automec v Commission of the European Communities* [1992] ECR II-2223 at para. 73.

[10] Keynote address by Mr E Van Ginderachter, Head of Unit, DG COMP/C/1, *IBC's 9th Annual Conference 'Communications and EC Competition Law*, Brussels, 14 October 2004.

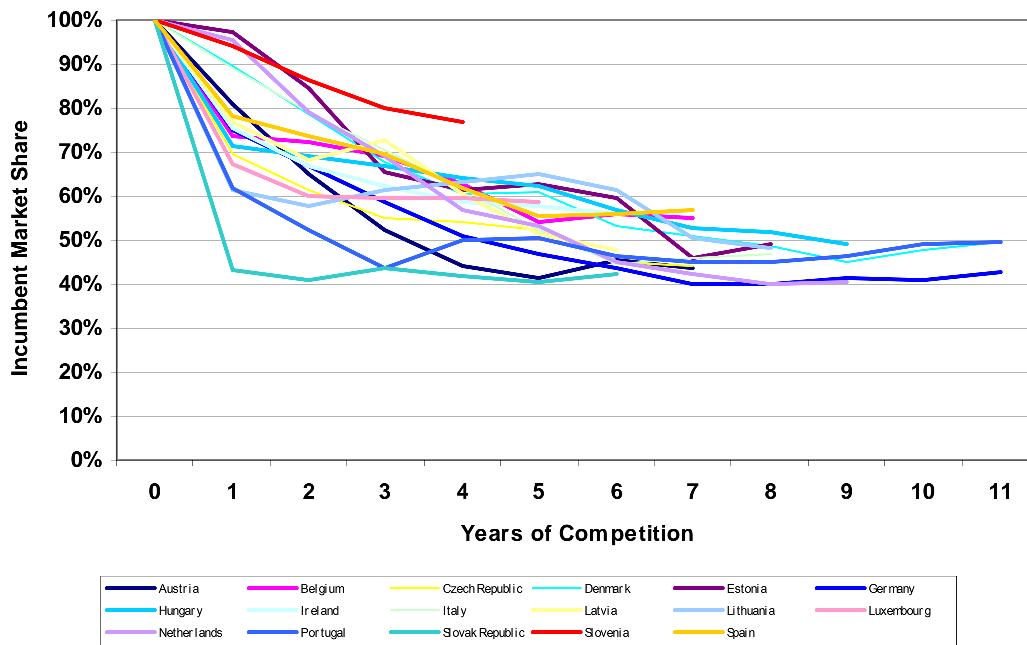
II. SUBSTANTIVE CLAIMS

II.1. Background

2.1 Vega is the third of three operators of mobile networks in Slovenia. It entered the market on 3 December 2001. The second entrant, Simobil, a subsidiary of Telekom Austria (and co-branded with Vodafone since 11 February 2003) entered the market on 1 March 1999. The 'incumbent' mobile operator, Mobitel, is owned by Telekom Slovenije, itself the monopolist majority state-owned fixed communications provider. Mobile penetration in Slovenia at the end of 2002 was approximately 75%, rising to 90% in 2003.[11]

2.2 After three years of competition, in June 2002, Mobitel had retained approximately 78% of Slovenia's mobile customers, with Simobil claiming to have approximately 21% of subscribers and Vega having acquired 1%.[12] By year end 2003, these shares had altered slightly, to be 78%, 20% and 2%, respectively. The following graph compares the rate at which Mobitel has lost market share during the period since Simobil entered the market with the simple rates of market share loss in the European Union Member States. Mobitel's rate stands out as being the least likely to be effectively competitive.

EU & Accession Countries (1992-2003)



[11] Figures derived from operator subscriber numbers, as published on their websites.

[12] This is an estimate from the Telecommunications, Broadcasting and Mail Agency (the "ATRP") 2003 annual report, issued on 8 March 2004.

2.3 Mobitel has adopted a sharply bifurcated tariff structure, for both post-paid and pre-paid tariffs, differentiating widely between on-net and off-net calls.[13] Vega believes that, for the reasons discussed below, the maintenance of such a significant on-net/ off-net tariff differential constitutes anti-competitive conduct by Mobitel, through its unfair and discriminatory pricing and cross-subsidisation to exploit the significant network effects that it enjoys as a result of its overwhelming dominance. Furthermore, Mobitel's pricing structures are not profit-maximising, as is illustrated below. As such, they amount to exclusionary conduct designed to retain market share in the short term, allowing it to price independently of competitors.

2.4 Vega has filed complaints with the Slovenian Competition Protection Office (the "NCA") and the Telecommunications, Broadcasting and Mail Agency (the "NRA") relating to Mobitel's conduct, and the breaches of both the *Prevention of the Restriction of Competition Act* and the *Telecommunications Act* that such conduct represents. However, largely due to the approach taken by the NRA, both in its capacity as the sector-specific regulator enforcing compliance with the *Telecommunications Act* and in its capacity as the sectoral 'expert' for the NCA, no action has been taken to address the substance of Vega's complaints in the eighteen months since they were filed. Vega's complaints are described in more detail in Annex 1 to this complaint.

II.2. The Relevant Market

Demand-side substitutability

2.5 The Commission has found, in a number of decisions,[14] and in its *Relevant Markets Recommendation*,[15] that there is a market for retail mobile communications services. In so doing, the Commission has noted that the key difference between fixed and mobile services is 'mobility'. As such, while the technical characteristics of the services that can be offered over fixed and mobile networks might increasingly converge (*e.g.,*

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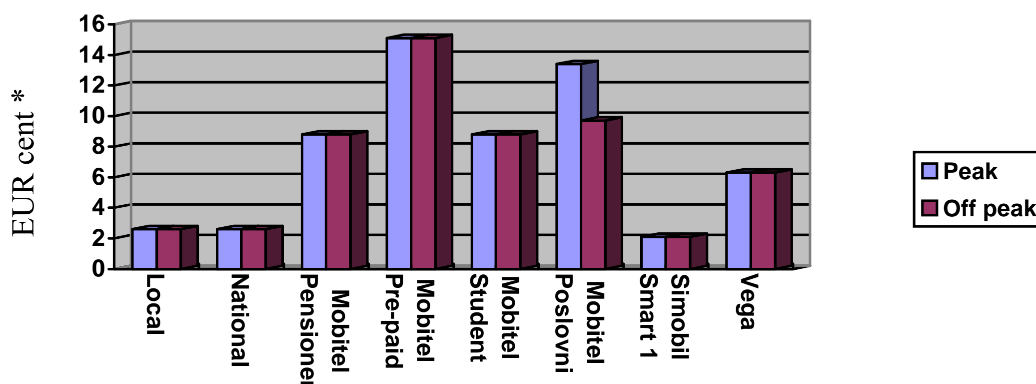
[13] In contrast, Vega notes that the price differential between on-net and off-net calls in Germany, Sweden, France, Italy and Spain in April 2004 was 0. While the differential in Belgium was 2.6, Vega notes that this pricing structure is currently the subject of legal action before the Belgian commercial court. Finally, in the UK, where the differential was 4, Vega notes the entirely different market structure and relative market shares. As such, by European standards, the Mobitel differential is significant.

[14] *See*, for example, *TeliaSonera*, Case No. COMP/M.2803; *Pirelli/Edizone/Olivetti/Telecom Italia*, Case No. COMP/M/2574; *Telia/Telenor* Case No. COMP/M.1439; *Vodafone Airtouch/Mannesmann* Case No. COMP/M.1795.

[15] *Commission Recommendation 2003/311/EC on Relevant Product and Service Markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services.*

transmission quality and bandwidth differences[16] might converge),[17] fixed services cannot and will not provide mobility.

2.6 Further, there are significant differences in the current pricing of retail fixed and mobile services in Slovenia. Mobitel and Simobil's rates are between one and seven times the fixed charges, while Vega's rates are two times the fixed charges.[18] The figure below illustrates these charges.



* VAT included

2.7 The price differences between fixed and mobile services, combined with their functional differences, confirm that, as in the Member States, Slovenian fixed and mobile services fall within separate and distinct markets.

2.8 Vega's experience of customer switching between pre-paid and post-paid packages suggests that such packages fall within one relevant product market. The behaviour of Slovenian customers suggests that they do, and can be expected to continue to, switch to post-paid packages in response to pre-paid price increases. While there are greater costs associated with switching from post-paid to pre-paid services (in terms of buying out contracts or paying for subsidised handsets through some other mechanism), anecdotal evidence of customer responses to tariff increases by Mobitel suggest that such costs do not prevent customer churn. Supply-side substitutability would support the conclusion that pre- and post-paid services fall within the same relevant market, given that the underlying post- and pre-paid services are exactly the same (with only the tariffing structure, billing process and some other terms and conditions of supply differing).

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[16] *See Vodafone/Vivendi/Canal+*, Case COMP/JV 48.

[17] Currently, such functional differences, including transmission quality, bandwidth and mobility, differentiate fixed and mobile services in Slovenia.

[18] Note that 'night' charges only apply between midnight and 5 am.

2.9 Vega believes that the Slovenian retail mobile services market is based on the provision of clusters of services. Given the take-up patterns for post-paid and pre-paid service packages,[19] it believes that retail 'access' is part of each service package. Slovenian post-paid packages include (alongside call charges) monthly charges. Mobitel's monthly charges range between €5.75[20] and €18.30, Simobil's range between €5 and €12.50, and Vega's between €4.38 and €67.38.[21] Pre-paid tariffs inherently reflect the equivalent of the post-paid access charge in the call charges. The significantly higher pre-paid tariffs reflect the incorporation of such monthly charges (and, usually, a portion of the 'activation' charges that are recovered as such from post-paid customers).

2.10 In addition to access, Slovenian mobile service users acquire a bundle of call and other services, comprising basic voice services (including international roaming), supplementary services (including voicemail, directory services and premium-rate services) and messaging services (SMS and, possibly, MMS). Each of these services is clearly functionally distinguishable. In fact, even within each service type, it is arguable that further, largely pricing-based, distinctions can be drawn (*e.g.*, between on-net and off-net call charges) which, adopting a demand-side analysis, could warrant the identification of narrower relevant markets.

2.11 However, such an approach might not accurately reflect the competitive dynamics of the market or, indeed, the range of considerations weighed-up by customers when selecting between packages (and providers).[22] As such, it might be appropriate to consider a broader relevant market that reflects the 'cluster' of services commercially offered (and acquired by consumers).

2.12 Having said this, Vega considers that it is important to acknowledge that consumers' selections between the available packages may place greater emphasis on the availability of and/or the conditions of supply (including relative and absolute price) of particular services within the packages and of particular calling times. In the Slovenian context, Mobitel's exploitation of network effects, through its abusive on-net pricing practices, has

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[19] Mobitel's published data indicates that its customer base is 50% pre-paid, 50% post-paid. Vega believes that Simobil's post-paid/pre-paid mix is approximately 30%/70%, while its own mix is approximately 45%/55%.

[20] For ease, prices are provided in EURO. The exchange rate between EURO and SIT is 240.

[21] Between 60 and 500 of calling minutes are built into these packages.

[22] *See*, for example, *McCormick/CPC/Rabobank/Ostmann*, Case No. IV/M.330; *Newell/Rubbermaid*, Case No. Iv/M.1355; *Mannesmann/Vallourec*, Case No. IV/M.906.

made the price of peak calls to non-Mobitel subscribers a key factor in service package selection.[23]

Supply-side substitutability

2.13 A review of supply-side substitutability makes it clear that, as long as their networks have capacity, mobile operators could easily switch such capacity to supply different services. The majority of the services made available in Slovenia are provided using the same mobile network, utilising essentially the same network elements (*e.g.,* the radio access network, similar elements of the core network and essentially the same operation and maintenance layer).

Geographic market

2.14 In Slovenia, as in other European jurisdictions, retail packages are offered on a national basis. While Simobil is Vodafone co-branded, there is little evidence that this has impacted on the national scope of the relevant market, at least to date.

II.3. Mobitel's Dominant Position

2.15 Mobitel is indisputably the dominant provider of all retail mobile communications services in Slovenia. As noted above, Mobitel has retained approximately 78% of Slovenian retail mobile communications service subscribers. Vega is not aware of Mobitel's market share calculated by reference to revenues or numbers of minutes. However, it notes that Mobitel has a disproportionate share of heavier using, higher spending customers than either Vega or Simobil. These customers are usually tied into four to six year contracts (as discussed in Section II.4, below). As such, Vega believes that Mobitel's market share calculated by reference to revenue or volume may in fact be higher than 78%. While market shares are in themselves an imperfect proxy for market power, a market share of over 78% over a period of a number of years is itself "evidence of a dominant position".[24] Further, Vega notes that the Slovenian NRA has made a finding that Mobitel has Significant Market Power (an assessment made under the old ONP-based regime).[25]

2.16 Vega also notes that Mobitel's market share, relative to that of both Simobil and Vega, the only other entities in the market, is significantly larger. It is approximately 3.9 times

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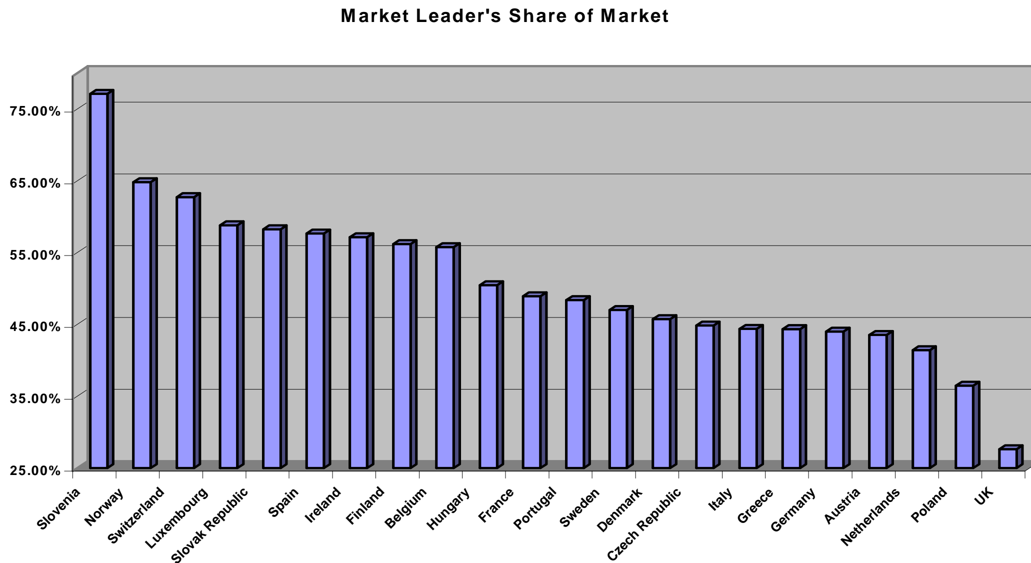
[23] Approximately 80% of mobile-to-mobile calls made in Slovenia are made during the 'peak' calling period, generating approximately 90% of mobile-to-mobile revenues.

[24] *Hoffmann-La Roche v Commission* [1979] ECR 461 at paragraph 56.

[25] While Mobitel appealed this decision, it did so on procedural grounds. The NRA has issued a second decision declaring that Mobitel has SMP.

Simobil's market share, and more than 35 times Vega's market share. By international standards, Mobitel's market share is by far the highest of all European mobile operators, as illustrated in the following graph.



Source: European Mobile Communications Report, June 2002.

2.17 Further, as noted above, Mobitel's rate of loss of market share has slowed and started to stabilise over the 12 months to the end of 2003. In the first three years following the entry of the second mobile operator, Mobitel lost 22% market share. In the year to the end of 2003, Mobitel lost only a further 2%, despite the fact that this was Vega's first full year of operation and the year in which Simobil entered into a co-branding arrangement with Vodafone and conducted an extensive marketing campaign.

2.18 In addition to possessing a large (in both absolute and relative terms) and relatively stable market share, there are a number of other barriers to entry that further enhance Mobitel's dominance. Mobitel is a wholly owned subsidiary of Telekom Slovenije which is, in turn, the State-owned fixed communications services provider. As such, Mobitel has enjoyed easy access to capital, and a lower cost of capital than any other operator in the Slovenian market.[26]

[26] There are a number of State aids issues that have arisen in relation to the funds that have been made available to Mobitel. Vega brought the following issues to the attention of Unit H-3 on 26 March 2004: the Slovenian State guaranteed an EBRD €114 million loan facility made available to Telekom Slovenije (at an interest rate of EURIBOR plus 0.06%). Telekom Slovenije used €87 million of that facility to increase Mobitel's capital, to enable it to acquire a UMTS licence. In addition to the provision of capital on uncommercial terms and the support constituted by the State guarantee, the interest rate obtained was clearly preferential and reflected the State support. Vega understands that the facility was recently refinanced, and has not been repaid. As such, the illegal State aid remains on foot.

2.19 Not only does Mobitel enjoy these advantages flowing from its ultimate State ownership but, in addition, it has anti-competitively taken advantage of the scope of the activities conducted by the broader Telekom Slovenije group. To date, this has extended to services including directory services and single billing for customers acquiring all services from Telekom Slovenije and its related companies (*i.e.,* fixed services from Telekom Slovenije, mobile services from Mobitel and Internet services from Siol). Mobitel's privileges also include the exclusive right to provide callers with access to a new computerised real property registry.[27]

2.20 Finally, Mobitel is further protected by the legal barriers to entry that result from the limited number of mobile services licences that have been granted and the finite available spectrum.

[27] In early June 2004, the Slovenian State launched a system providing Internet-based access to the Slovenian land register (at www.sodisce.si). However, the payment mechanism for gaining access is based exclusively on Mobitel's 'moneta' (e-money). As a result, only Mobitel's customers can use the system.

II.4. Mobitel's Abusive Conduct

2.21 Mobitel's market behaviour displays a number of exclusionary abuses. In particular, its behaviour is such as to influence the structure of the market (already weakened as a result of Mobitel's presence) through methods that differ from those which condition normal competition, hindering the maintenance of the degree of competition existing in the market or the growth of that competition.[28] Mobitel has not met its 'special responsibility', as a superdominant undertaking not to impair genuine undistorted competition on the common market.[29]

2.22 In particular, superdominant Mobitel's on-net/off-net pricing policy is part of an exclusionary strategy, effectively subsidised by the Slovenian State, which operates as a significant barrier to effective entry and to expansion and a disincentive to churn in a saturated market.[30] Further, the practice deprives Mobitel's competitors of termination revenues that undistorted calling patterns would be expected to generate, as it operates as a powerful deterrent to Mobitel customers calling customers of its competitors.

<u>Pricing Practices</u>

2.23 Mobitel has adopted a sharply bifurcated tariff structure, for both post-paid and pre-paid tariffs, that anti-competitively differentiates between on-net and off-net calls. Most importantly, its pricing structure is not profit-maximising and is designed to exploit the network effects that it enjoys to make it impossible for any customer whose 'community of callers' (*i.e.*, those other mobile customers who call them) is composed of Mobitel customers[31] to acquire services from Vega (*e.g.,* because members of the particular community of callers would pay up to 2.5 times more to call the Vega customer than another Mobitel customer, they simply do not call the Vega customers).

Mobitel's Pricing Practices

2.24 At the outset, Vega notes that Mobitel enjoys a market position of overwhelming dominance, at or approaching superdominance, in a highly concentrated market. As such, the elimination of one of its two competitors clearly holds out the opportunity to further strengthen its market position in the immediate short-term, and to continue to

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[28] *Hoffman-La Roche v Commission* [1979] ECR 46, at para. 91.

[29] *Michelin v Commission* [1983] ECR 3451, at para. 57.

[30] As Mobitel itself notes in its 2003 Annual Report (English language version), there is *"an unusually low annual migration to the competition (if we compare the migration share data to those from foreign countries)"* at pg. 3.

[31] In this context, the 78% market share that is clearly at the core of the network externalities that Mobitel exploits through on-net/off-net tariff differentiation.

erode the market share of Simobil (the second competitor), with a view to reverting to an essentially unchallenged and unchallengeable virtual monopoly position.

2.25 As noted, Mobitel has adopted a sharply bifurcated on-net/off-net tariffing policy, and has followed this policy for the last five years.

2.26 Prior to August 2003, the Mobitel ratio between off-net and on-net peak calls ranged between 1.8 and 2.8. For the three most popular Mobitel tariff plans the peak range was 2.2 to 2.7.[32] Between August 2003 and April 2004, the ratio across all peak calls ranged between 1.5 and 2.8, with the range for the three most popular tariffs having actually increased to between 2.3 and 2.8. Vega notes that Mobitel's August 2003 tariff adjustment appears to entail strategic and deliberate accentuation of the on-net/off-net ratio for the three most popular tariffs, despite the fact that Vega's complaints with the Slovenian NRA and NCA respectively, were filed four and five months earlier. In particular, Mobitel increased the ratio by 3.7% for the post-paid plans and 4.5% for the pre-paid 'Mobi' plan.

2.27 As a result of the April 2004 tariff adjustment, the peak calls ratio ranged between 1.4 and 2.5, with the range for the three most popular tariffs adjusting slightly to between 2.0 and 2.5. In addition to the negligible adjustments for these most popular tariff packages, the adjustments left the differential in the business packages unchanged. In essence, while the April 2004 adjustment resulted in a 5 to 7% decrease in prices for off-net calls and a 3 to 5% increase in prices for on-net calls, it had negligible impact on the most popular and the most profitable tariff packages. They were returned to slightly below the pre-August 2003 level.[33]

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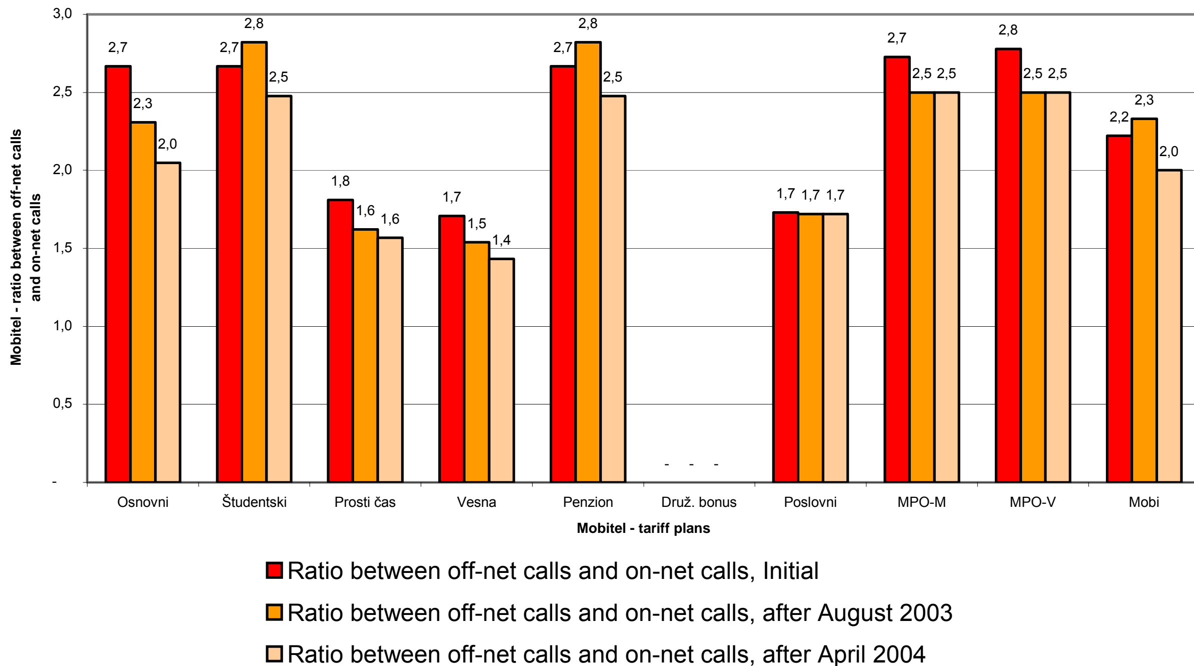
[32] Vega understands that Mobitel's three most popular tariffs are 'Studentski', 'Penzion' and 'Mobi'.

[33] Mobitel's new Enotni tariff has no on-net/ off-net differential. However, its peak rate is €0.16 and the monthly fee is by far the highest of any of the Mobitel tariffs (€18.75), making it Mobitel's most expensive tariff overall, by a significant margin. As a result, its take-up has been negligible and it has had no impact on the market.

The evolution of the peak on-net/ off-net ratios can be illustrated as follows:



2.28 These prices (and their evolution over time) amount to a combination of unfairly low and unfairly high prices, with the latter being used to cross-subsidize the former, to effectively preclude customer churn in a saturated market. In particular, they have used sharply differentiated on-net/off-net tariffs to significantly hinder competition and to place competitors (in and entering the market) at a significant competitive disadvantage.

Article 82 Treatment of Predatory Behaviour

2.29 As the European Courts have made clear, Article 82 prohibits a dominant undertaking from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the basis of quality. Increasingly, the European Courts have focused on the special duty owed by a dominant operator in the context of predatory behaviour. Similarly, the Commission focused on foreclosure through mechanisms that prevent customers from switching to offer suppliers, in *Van den Bergh Foods Limited*,[34] noting that such mechanisms interfere with the ability to choose suppliers in the basis of the merits of the products offered, making market penetration and expansion more difficult.

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[34] Case Nos IV/34.073, IV/34.395 and IV/35.436, paras. 265 and 266.

2.30 At a fundamental level, not all competition by means of price can be regarded as legitimate.[35] A number of more recent judgments of the European Courts have considered anti-competitive pricing practices outside the classic 'predatory pricing' framework.

2.31 Advocate General Fennelly in *Compagnie Maritime Belge* noted that, where an undertaking enjoys a position of dominance approaching a monopoly, particularly on a market where price cuts can be implemented with relative autonomy from costs, it might not be appropriate to accept a policy of selective price cutting (with the demonstrable aim of eliminating all competition), even if the undertaking is selling above cost.[36] He went on to comment that Article 82 EC cannot be interpreted as permitting monopolists or quasi-monopolists to exploit the very significant market power which their superdominance confers so as to preclude the emergence of a new or additional competitor. As such, he concluded that it would not be consonant with the particularly onerous special obligation affecting such a dominant undertaking to adopt a policy of targeted, selective price cuts designed to eliminate a competitor.[37]

2.32 The CFI took a similar view in *Irish Sugar*.[38] In particular, it noted that it is necessary to consider all of the circumstances, including whether, in providing an advantage not based on any economic service justifying it, the pricing tends to remove or restrict the buyer's freedom to choose its sources of supply, to bar competitors from access to the market, to apply dissimilar conditions to equivalent transactions or to strengthen the dominant position by distorting competition. Further, the Court noted that the distortion of competition arises from the fact that the financial advantage to the dominant undertaking is not based on any economic justification; rather, it tends to prevent its customers from obtaining their supplies from competitors.[39]

2.33 The CFI's judgments in the *Michelin*[40] and *British Airways*[41] cases in the last quarter of last year further considered the assessment of potentially predatory behaviour. In both cases, the CFI reaffirmed that, in considering whether the conduct of an entity in a

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[35] *AKZO Chemie v Commission* [1991] ECR I-3359.

[36] [2000] ECR I-1365, at para. 132.

[37] *Ibid*., at para. 137.

[38] *Irish Sugar v Commission* [1999] ECR II-2969.

[39] *Ibid*., at para. 114.

[40] Case T-203/01 *Manufacture française des pneumatiques Michelin v Commission of the European Communities*.

[41] Case T-219/01 *British Airways plc v Commission of the European Communities*.

dominant position goes beyond competition on the merits, it is necessary to consider whether the conduct is based on an economically justifiable countervailing advantage (*e.g.,* it rewards an economy of scale or efficiency gains). As the CFI noted in *British Airways*, pricing can be abusive if it produces an exclusionary effect, particularly where such pricing behaviour has the effect of preventing customers from obtaining supplies from rivals.[42] Such an exclusionary effect might be achieved through discriminatory behaviour. Further, as both cases confirmed, fidelity enhancing pricing with a foreclosing effect goes beyond the bounds of competition on the merits.

2.34 The United Kingdom's Competition Appeals Tribunal (the 'CAT') considered not dissimilar pricing practices in *Napp Pharmaceutical Holdings*.[43] Napp enjoyed market shares in the point of entry segment of the relevant market of 92%, and 95% in the other segment.[44] Its prices were sharply differentiated: the prices of products in relation to which Napp faced competition were below direct costs (at some times, significantly so). Napp argued that there were 'follow on' effects in the non-point of entry segment that made the pricing, as a whole, profitable. However, noting Napp's inability to actually show that it took account of any such effect in price setting, the CAT took the view that Napp's pricing practices were driven by the role of the entry point segment as a 'gateway' to the community segment, and that it appreciated the general and unquantifiable impact of its behaviour in the entry point segment on market share in the larger second segment. Further, the CAT found that the effect of the pricing policy, in raising the barriers to entry, had been significant.

2.35 The CAT's conclusions, at paras. 334 to 339, are particularly pertinent in the present case. It found that:

- Napp's policy of selling below direct cost to hospitals, on a selective basis, had a significant effect in hindering competition in both segments of the market;
- existing and potential competitors seeking to enter or to gain market share in the gateway segment and, ultimately, the other segment, were placed at a significant competitive disadvantage by Napp's discounting policy;
- Napp's intention was, so far as possible, to eliminate competition by preventing or hindering market entry into both segments; and
- Napp's primary motivation was not to make 'extra sales' or 'an incremental profit' (from follow-on benefits), but to deny to its competitors a key means of entering the market though the gateway segment.

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[42] *Ibid*., at paras. 233 and 244.

[43] *Napp Pharmaceutical Holdings Ltd and others v Director General of Fair Trading*, [2002] 4 All ER 376.

[44] The entry segment was sales to hospitals, with sales outside hospitals falling into the alleged follow-on segment.

2.36 Finally, Vega notes the Commission's discussion of the exclusionary, market-foreclosing nature of the pricing conduct, designed to capture the market, in the respective investigations in *Wanadoo,*[45] *TeliaSonera*[46] and *Deutsche Telekom*.[47]

Mobitel's Abusive Exploitation of Network Externalities

2.37 Vega considers that Mobitel's pricing practices must be appraised in light of the particular dynamics resulting from its broader predatory behaviour, particularly its exploitation of network externalities. The following brief discussion identifies the manner in which Mobitel is exploiting its network externalities.

2.38 It is well recognised that network industries have special characteristics (that can arise on both the supply and demand side). On the demand side, if users value larger networks more than smaller networks, this will support the further growth of the larger network, and disadvantage smaller networks. The incentives to adopt a 'winner-takes-most' strategy that this creates tend to encourage and/or result from anti-competitive practices. In particular, the classic network externality (where the network becomes more valuable to each user as more users connect) is reinforced in an environment of interconnected networks by pricing practices that recreate a single network-based 'network of callers'. Mobitel has the means and the incentive to tip the market. Customer 'lock-in' effects (occurring where significant switching costs discourage customers who fear being 'stranded' if they were to churn to a smaller network and when churning would lead to higher prices) exacerbate the problem.

2.39 In previous cases, the Commission has considered the possibility of anti-competitive conduct flowing from the exploitation of network externalities by allegedly dominant undertakings, including serial degradation at points of connection between networks[48] and the leveraging of trans-national footprints.[49] There exist a number of key features in the particular facts of this case which compellingly support the argument that Mobitel is abusing network externalities. Particularly:

- Mobitel is not exploiting the network externalities with a view to building market share in a growing market; rather, it is doing so to slow the loss of customers to new entrants offering lower average call charges in a mature market;

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[45] Case COMP/38.233 - *Wanadoo.*

[46] Case COMP/37.451, 37.578, 37.579 – *Deutsche Telekom AG OJ L263, 14.10.2003, p.9.*

[47] Case COMP/37.663 – *B2/Telia*

[48] *See WorldCom/MCI* Case No. M.1069.

[49] *See Vodafone Airtouch/ Mannesmann* Case No. COMP/M. 1795.

- Mobitel is not imposing higher prices on those calling its customers (*i.e.*, through termination charges); rather, it is setting its own retail calling charges at levels that discourage its customers, in a saturated market, from:
  - churning, because they know other Mobitel customers will not call them (and incur Mobitel's off-net charges) after they churn to Vega's network; and
  - calling its competitors' customer; and

- Mobitel has created a 'network of customers', rather than a physical infrastructure network, through its pricing practices.

2.40 A small body of research exists which considers the impact of pricing strategies such as those employed by Mobitel on consumer purchasing decisions (*e.g.*, demand) in the face of network externalities. Blonski's work is particularly pertinent in this respect.[50] He has considered the effect of non-symmetric two-part tariffs as a means of 'enhancing the strength' of network externalities. As he notes, a new entrant can reduce its 'entry fee' to ensure that it attracts a 'small fraction' of customers at the low-demand boundary (since such customers only compare entry fees). Given this, Blonski finds that inter-network access fees are the main obstacle for the installed base of customers to switch to the entrant (whether or not the entrant has a lower retail tariff structure and lower 'entry fees'). He also finds that the imposition of an access charge (by each network supplier, on inbound calls) makes it cheaper to call within the incumbent's network. Similar conclusions are reached by Frontier Economics in their recent paper.[51] However, the Commission should be mindful of the key factual differences between the models underpinning these papers and the present circumstances.

2.41 Mobitel's off-net charging structures create the same enhanced network effects that the imposition of a high access charge by Vega would create. However, it is important to recall that Vega is not imposing such a charge. The 'tipping' effect that Mobitel is employing to retain its market share is a function of its own anti-competitive tariff structures, not Vega's termination charges.[52] Mobitel is, by manipulating the prices charged to its own installed base to exclude new entrants from the market, simulating the role of access fees in Blonski's model. As such, Mobitel is using its on-net/off-net tariff differential to erect the barrier to its installed base of customers switching to the entrant.

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[50] Blonski, M. *"Network externalities and two-part tariffs in telecommunication markets"*, Information Economics and Policy 14 (2002) 95-109.

[51] *"Two-way access charges and on-net/off-net differentials"*, Dan Elliott, Frontier Economics; October 2004.

[52] The Slovenian NRA issued a temporary ruling ordered, in July 2003, that Mobitel and Simobil adjust their termination rates. That decision was subsequently overturned by the Ministry of Information Society. Mobitel and Vega currently have symmetric termination rates, set at 8 SIT off-peak and 27 SIT peak.

Members of its installed base know that if they switch, remaining members of Mobitel's base will not call them (since those remaining members are also well aware of the price differential. Vega's understanding of the economic literature is supported by the views of Professor Martin Cave, whose expert opinion is attached at Annex 3 to this complaint.

Discriminatory Pricing

2.42 Mobitel's on-net/off-net pricing is discriminatory, on the basis of the segmentation of the called parties (by network), rather than segmenting the calling parties, so-called third degree price discrimination. The UK's Competition Commission noted the anti-competitive effect of discriminatory on-net and off-net tariffs in its February 2003 report.

2.43 Vega acknowledges that a degree of price discrimination can be beneficial to the extent that it increases overall production (by providing an incentive to supply the product to everyone willing to pay at least the incremental cost of production) and, accordingly, overall welfare. However, Mobitel's discriminatory pricing is not welfare enhancing. In the present circumstances, acting to prevent such behaviour is, for the reasons set out below, more beneficial to competition than the maintenance of the *status quo*.

2.44 It is clear that Mobitel's discriminatory pricing is not intended to, and does not have the effect of, introducing "low value" customers that would not otherwise be part of the customer base (allowing common costs to be spread across a broader base), not least because the market is already close to saturated and the on-net/off-net tariff structures do not differentiate by reference to the "value" of the calling party. The pricing has the effect of preventing customers from churning to rivals in a manner not dissimilar to that condemned by the CFI in *British Airways*.

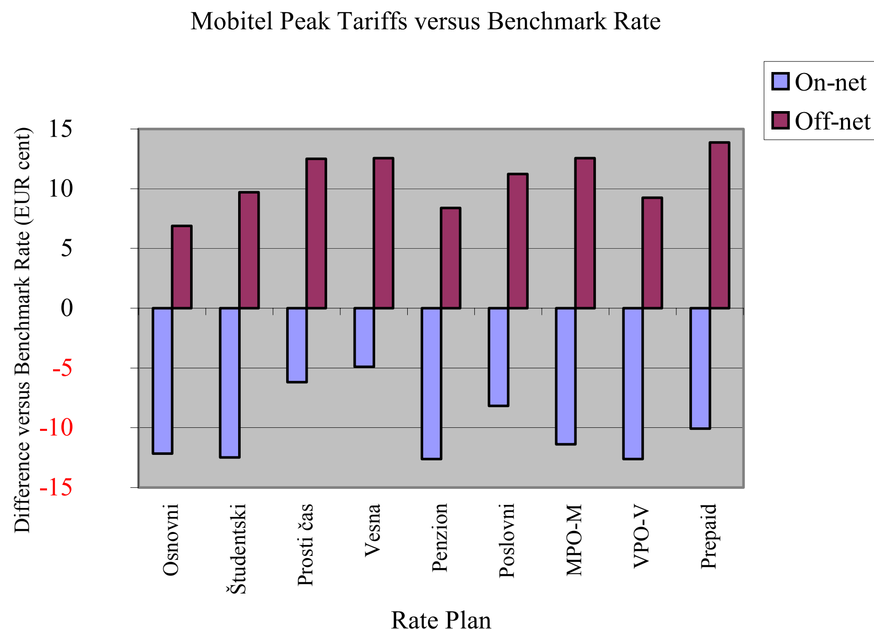
2.45 As described below, the 'transactions' occurring in the making of on-net and off-net calls are the same; it is merely the identity of the terminating operator that changes. As such, both types of calls entail equivalent transactions. Further, Mobitel's conduct disadvantages its competitors, its customers (when they call Mobitel's competitor's customers) and Slovenian mobile customers more broadly (by precluding them from being able to take advantage of the service offerings and lower average prices of Mobitel's competitors). In essence, the excessively low, discriminatory on-net tariffs have led and continue to create primary-line injury to competition.

Failure to set prices at levels reflecting costs

2.46 While it is notoriously difficult to agree the appropriate methodology to calculate the costs of mobile communications services, let alone agree on the costs, the significant on-net/ off-net differential permits a comparison of the relative costs to be made. It appears to be relatively clear that the costs of originating both on-net and off-net calls are similar. As the ART noted in the review of Bouygues Telecom's complaint relating to Orange

France's attempt to introduce differentiated on-net and off-net charges,[53] the cost of a mobile to mobile call flows principally from the use of two network elements: (i) radio connection and the role of localisation; and (ii) the costs of other network elements (including termination outpayments).[54] The costs of radio connection and localisation are estimated to be ten times larger than those other costs. A complete analysis of the relevant network elements and costs is set out in Annex 2 to this complaint.

2.47 Since both on-net and off-net calls use similar network elements for origination, the difference in cost base, if such a difference exists, results largely from the cost of termination. As such, the only legitimate justification for an off-net premium would appear to be the existence of asymmetric termination charges. The ART also adopted this view.[55] Mobitel and Vega have symmetric termination charges. As such, Vega believes that Mobitel's differentiated tariffs cannot be cost justified.



2.48 Vega believes that the data indicates that Mobitel's policy of selectively providing on-net calls below cost, coupled with recoupment from above cost off-net calls places, and is intended to place, Mobitel's competitors at a significant competitive disadvantage, by hindering effective and sustainable market entry.

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[53] ART Decision No. 02-D-69 of 26 November 2002, section 3.4.1.

[54] Annex 2 to this complaint diagrammatically represents the relevant network elements.

[55] *Ibid*., final paragraph of section 3.4.2.

Mobitel's predatory on-net tariffs

2.49 While it is difficult to calculate average total or variable costs in the communications sector, the Commission's decision against *Wanadoo Interactive*[56] and the OFT's *BSkyB* decision [57] suggest that a number of the methodological issues previously identified can be addressed in Mobitel's circumstances. Both cases confirm that anti-competitive pricing abuses should be assessed using historic models based on actual market data (rather than forward looking models) because forward-looking models risk concealing the abuse; they are circular; they cannot assess anti-competitive pricing behaviour over discrete historical periods; and they rely on speculative cost data and forecasts.

2.50 Vega does not have a break-down of Mobitel's average total or variable costs. However, the graphs above make it clear that Mobitel's on-net peak rates are between €0.14 and €0.06 below a sum that represents twice Mobitel's termination rate (*i.e.,* between 25 and 63% of the 'benchmark' termination figure). Vega believes that Mobitel's profitability ratio,[58] ROE (return on equity)[59] and ROCE (return on capital employed)[60] are such that it is clear that Mobitel is not covering at least its average variable costs with these on-net tariffs. Such uncommercial practices, given Mobitel's market position, can only be explained in one way.

2.51 In light of the significant number of customers that remain with Mobitel, it is inappropriate to consider the predatory nature of Mobitel's on-net/off-net bundle. Few off-net calls are made by Mobitel customers. However, Vega notes that, even if one were to assume that 20% of Mobitel's customers' calls were off-net (an unsustainably high proportion, in the circumstances), the average tariff would be below both the incremental cost of each service and the total costs of all services.

2.52 Thus, it can be deduced that Mobitel is setting these tariffs with a view to eliminating its competitors in the Slovenian mobile communications market. As discussed below, these tariffs are not profit-maximising, nor do they relate to a market in which demand is shrinking; nor do they relate to new products, products for which Mobitel also provides complements or products in markets related to other retail markets in which Mobitel

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[56] Commission press release, 16 July 2003, IP/03/1025.

[57] Decision No CA 98/20/2002.

[58] Using the figures in Mobitel's 2003 Annual Report, it appears that its profitability ratio was 4%. Vega calculated return on sales by dividing net profit from ordinary activities by net sales revenue.

[59] Using the figures in Mobitel's 2003 Annual Report, it appears that its ROE was 5.2%.

[60] Using the figures in Mobitel's 2003 Annual Report, it appears that its ROCE was 5.5%. Vega calculated ROCE by dividing EBIT by total assets (less current liabilities).

operates. As such, the purpose behind, or, at least the effect of, Mobitel's strategy is unambiguously exclusionary. While it is not necessary that Mobitel's pricing has an "effect" on the market for it to be predatory,[61] it is clear that it does so. It clearly affects the ability of Mobitel's competitors to both expand their market presence (in fact, Simobil is losing market share, despite its relationship with Vodafone and aggressive marketing) and to innovate (to allow them to compete on quality and other bases, since they cannot compete on price). Despite the fact that Vega's average tariff is well below Mobitel's average tariff, it is unable to compete for customers on price. In a concentrated market, these effects (on both of Mobitel's competitors) have an adverse effect on competition in the market.

2.53 Further, Vega notes that Mobitel is largely insulated against additional entry (and potential re-entry, if one of its competitors were to exit the market) by the entry barrier represented by the necessary spectrum licence. It might also be that, over time, Mobitel's pattern of conduct as a predator has, in itself, become an additional means of deterring entry, especially where it is clear that the regulatory authorities cannot contain or curb that predatory conduct.[62]

2.54 Finally, Vega notes that Mobitel's pricing patterns, and motivation, are not dissimilar to those considered in *Napp Pharmaceutical Holdings*. Mobitel is using its on-net pricing as a "gateway", to preserve its network of subscribers (through the differentiation of its on-net and off-net prices). Further, it has manipulated predatory and above-cost pricing in a similar manner.

Mobitel's tariffs are not profit maximising

2.55 Vega has reviewed Mobitel's published 2003 accounts, and has calculated the revenues, EBITDA margin, profitability ratio and return on equity had Mobitel, in 2003, adopted comparable on-net and off-net charges. The calculations show that:

- Revenues would have increased 11%;
- EBITDA would have increased 34% (from 32.1% to 38.7%);
- Profitability ratio would have improved by 98% (from 5.5% to 11%); and
- Return on equity would have improved 107% (from 5 to 10.3%).[63]

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[61] *See, BA* and *Michelin II, inter alia.*

[62] *See*, for example, US District Court for the District of Columbia, Civil Action No. 98-1232 (TPJ): *United States of America v. Microsoft Corporation*; *State of New York et al v. Microsoft Corporation*; *Microsoft Corporation v. Eliot Spitzer, attorney general of the state of New York, in his official capacity, et al*, Findings of Fact, paras 411-412.

[63] These calculations are based on an analysis of the financial results of Mobitel d.d. published in the Mobitel d.d. 2003 annual report and incorporates usage and price elasticity assumptions based on general industry practice.

2.56 As such, it is clear that Mobitel's tariff structures are not profit maximising. Rather than being designed to make "extra sales" which might generate an incremental profit, they are intended to deny competitors a means of being able to encourage customers to churn (in an increasingly saturated market). They are part of a pattern of exclusionary conduct designed to drive competitors from the market.

Cross-subsidisation of on-net calls by off-net calls

2.57 Vega has analysed the extent to which Mobitel's tariff structure leads to the cross-subsidisation of on-net calls by off-net calls. In doing so, it has taken a 'benchmark' rate that is approximately twice the termination charge, since the Slovenian termination rates are not truly cost based and, therefore, inherently include a margin for customer management and other common costs that would not ordinarily be reflected in a genuinely cost-based termination rate. The following graphs illustrate the extent to which Mobitel's off-net charges exceed the benchmark and its on-net charges. This structure clearly amounts to the cross-subsidisation of on-net calls by off-net revenues, to create incentives for Mobitel customers to both remain Mobitel customers and to ensure that others in their community of users also remain Mobitel customers.

Non-pricing Practices

2.58 The exclusionary effects of Mobitel's pricing practices are exacerbated by a number of non-pricing practices which further bolster Mobitel's position in the market and render its customers uncontestable.

Customer contracts of excessive duration

2.59 Mobitel includes a number of other provisions in its customer contracts that constitute "unfair trading conditions". In particular, it imposes terms effecting contractual duration of 24 months (until recently, the duration was 36 months), well in excess of the period required to recover the amortised costs of customer acquisition or to recover the subsidy that might be related to handset provision. In addition, customers acquiring subsidised handsets during the term of their contracts have their contract term prolonged by an additional period of 24 months, for each such handset (until recently, this period was 36 months). As such, it is not uncommon for customers to be parties to contracts of four to six years duration. Vega believes that Mobitel enforces these contractual conditions.

2.60 In addition, Mobitel reinforces the effect of the duration of its contracts by SIM-locking handsets. Such handsets are SIM-locked for an indefinite period. Even after the expiration of a customer's contract, customers must pay a fee to have their SIM-locked handsets unlocked.

2.61 Mobitel's conduct in relation to these non-price terms of its customer contracts is part of its overall anti-competitive exclusionary behaviour and strategy.[64] Mobitel is using such terms as a further mechanism to hinder the migration of its customers to other mobile operators, with a view to driving such operators from the market and reducing customer choice.

Publication in the Telekom Slovenije phonebook

2.62 Telekom Slovenije published Mobitel customers' mobile phone numbers in its Spring 2003 phonebook. Neither Simobil nor Vega were offered access to the phonebook. Telekom Slovenije is the monopolist publisher of the Slovenian national phonebook.

2.63 While this conduct did not occur in the relevant product market for retail mobile communications services, it has occurred in a related market and is a factor taken into account by customers in selecting their mobile operator (*e.g.,* accessibility of their number to others wishing to call them) as it provides the most widely used source of telephone numbers in Slovenia.

2.64 In response to Vega's complaints about Mobitel's exclusive access to the Telekom Slovenije directory,[65] Telekom Slovenije offered Vega access at a rate of €0.13 per number published per month. Vega believes that it would not be commercially viable for Mobitel to have accepted such terms, because it would lead to an annual charge of approximately €1.44 million (approximately 1% of Mobitel's total revenues). As such, Vega believes that it was offered access on terms that were significantly less attractive than those provided to Mobitel, which were, effectively, discriminatory and effectively amounted to a constructive refusal to deal.

2.65 Recently, Mobitel submitted a revised offer to Vega to include their subscriber's numbers in the Spring 2005 directory. As a result of Vega's objections to the initial offer, Telekom Slovenije lowered the price to €0.08 per number published per month. Vega believes that these revised terms are still significantly less attractive than those provided to Mobitel. As such, they remain discriminatory and effectively amount to a constructive refusal to deal.

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[64] *See*, for example, Commission Decision 93/50/EEC on *Astra* Case IV/32.745 OJ L20, 28.01.1993, p.23.

[65] The Telekom Slovenije directory is available as a published volume, on CD-ROM, on-line and as a DQ service (charged at €0.50 per call).

III. INTERIM MEASURES SOUGHT

3.1 Article 8 of Regulation 1/2003 provides that, in cases of urgency due to the risk of serous and irreparable damage to competition, the Commission, acting on its own initiative, may by decision, on the basis of a *prima facie* finding of infringement, order interim measures. As such, it would appear that the criteria that were established by the European Courts in relation to applications for interim measures prior to 1 May 2004 should continue to underpin the Commission's consideration of such applications. In particular, there must be:

- a *prima facie* case of infringement of Article 82;[66]
- urgency; and
- a serious risk of irreparable harm to the applicant or the public interest.

3.2 Vega believes that the present circumstances, as described above, establish a *prima facie* case that Article 82 is being infringed by Mobitel. There is little doubt that Mobitel is overwhelmingly dominant in all of the potential relevant product markets. Further, the tariff data provides *prima facie* evidence of predatory behaviour.

3.3 Further, the nature of the predatory and foreclosing behaviour of Mobitel raises a serious risk of irreparable harm to both Vega and the public interest that requires urgent action. As the Court of First Instance acknowledged in *La Cinq*,[67] the risk of 'cessation of business or insolvency' is the touchstone for establishing a risk of serious and irreparable damage. Western Wireless has invested approximately €160 million in Vega to date. However, the clear structural and institutional problems in the Slovenian mobile sector, coupled with the anti-competitive behaviour of Mobitel, are such that its shareholders have indicated that it is not economically feasible to continue to invest in or to sustain the company in the absence of significant and rapid change to the regulatory environment. Vega's project financing is now fully guaranteed by the shareholders as its line of credit was frozen by their banking consortium in 2003 and this situation will not be resolved in the absence of concrete regulatory measures being taken. It is clear that Vega's exit from the Slovenian mobile market would not only lead to irreparable harm to Vega, but that the reversion to a duopolistic market structure in which one operator continues to be overwhelmingly dominant represents a serious risk of irreparable harm to the public interest.

3.4 As Vega's discussions to date with the Commission have indicated, it is imperative that action be taken urgently. Vega has been seeking action under Article 82 EC Treaty since Slovenia's accession on 1 May 2004, and sought redress under Slovenian domestic law

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[66] *Camera Care v Commission of the European Communities* [1980] ECR 119; *La Cinq v Commission of the European Communities* [1992] ECR II-001.

[67] *La Cinq v Commission of the European Communities, ibid*., at para. 70.

some 18 months ago. It has not delayed in seeking relief; further, it has made the size of its investment to date and the uncommercial return being generated by that investment absolutely clear to the Commission since 22 April 2004.

3.5 Accordingly, Vega seeks interim relief against the discriminatory and predatory practices of Mobitel. In particular, it requests that the Commission impose on Mobitel provisional measures to remain in force until a final decision is reached:

- requiring it to diverge only by an amount representing the difference in costs, when it is setting its off-net and on-net retail tariffs (for these purposes, the termination costs of off-net and on-net calls should be considered to be the reciprocal termination charge);
- requiring it to set its on-net tariffs at a level that exceeds its mobile termination rate by an amount which covers the incremental network and retail costs of call origination;[68]
- precluding it from entering into retail contracts of duration longer than 12 months (including automatic renewal periods) and from enforcing or otherwise giving effect to contracts of longer duration that might already be in force;[69] and
- unlock SIM-cards, on request by customers who acquired their handset twelve of more months prior to making such request, without charge and within 48 hours of receipt of such request.

3.6 Vega's Slovenian economists have calculated that Mobitel's abusive conduct has led to Vega suffering damages quantified at up to €173.9 million, if action is taken to immediately address the regulatory environment, or €330 million, should Vega be forced to exit the Slovenian market.[70]

3.7 Vega notes that the interim measures sought are temporary and conversatory in nature,[71] and come within the framework of the final measures sought.[72] Moreover, they go no further than is necessary to address the particularly pernicious foreclosing behaviour of

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[68] Alternatively, a mark-up of 50% above Mobitel's termination rate for its on-net tariffs might serve as an interim proportionate response.

[69] *See*, for example, *Astra* 93/50/EEC.

[70] *See* attached paper at Annex 4, *'Loss of Subscribers and the Value of "Vega"',* V. Bole and R. Vocjak, October 2004.

[71] *Camera Care v Commission of the European Communities, op cit*.

[72] *Automobile Peugeot SA and Peugeot SA v Commission of the European Communities* [1991] ECR II-653.

Mobitel. The present case is on all fours with *BBI/ Boosey and Hawkes*,[73] in that the interim measures sought will do no more than ensure that Vega is not forced to exit the market by the predatory behaviour that is the very source of Vega's complaint, pending a final decision in the matter. This will be accomplished by ensuring that Mobitel's retail services are not priced below related wholesale services which Mobitel insists are cost-based and that customers are 'contestable' (rather than being tied to contracts of between four and six years effective duration).

* * * * *

[73] OJ [1987] L 286/36.

Annex 1 - Vega's Complaints to the Slovenian Authorities

Complaint to the Slovenian NCA

On 16 May 2003, Vega complained to the Slovenian NCA concerning the following breaches by Mobitel of the *Prevention of the Restriction of Competition Act* (the "Act"):

- Article 10 of the Act, as a result of:
  - setting retail prices that are unfair and are not cost-oriented, to inhibit the development of sustainable competition in the Slovenian retail mobile communications service market;
  - cross-subsidisation of unfairly low on-net tariffs by excessive off-net tariffs; and
  - unilaterally including unfair terms in end user contracts, including terms leading to anti-competitively long contractual terms and terms effecting automatic renewal;

- Article 5 of the Act, in entering into an exclusive agreement with Telekom Slovenije for the publication of Mobitel's subscribers' numbers in the public telephone book.

The NCA commenced proceedings against Mobitel on 20 June 2003. However, no action has been taken by the NCA to effectively investigate Vega's complaint in the twelve months since it was filed. The NCA has yet to commence its investigations or to appoint an independent expert to evaluate the complaint.

Complaint to the Slovenian NRA

One month prior to filing its complaint with the NCA, Vega filed a complaint with the Slovenian NRA alleging that Mobitel had breached the following provisions of the *Telecommunications Act*:

- Article 75(1) and (2) of the *Telecommunications Act*, as a result of not pricing its retail services by reference to the costs for efficient provision of those services; and

- Article 77 of the *Telecommunications Act*, through the cross-subsidisation of on-net calls by off-net calls.

In addition, this 17 April 2003 complaint noted that Mobitel's tariff structure is inhibiting the development of competition in the Slovenian mobile sector and amounts to an abuse of its dominant position, concluding by alleging that Mobitel's conduct amounts to a breach of its mobile service licence.

In response to Vega's complaint, the NRA commenced proceedings against Mobitel and Simobil. issuing a temporary ruling setting mobile voice termination rates on 10 July 2003. The ruling was to take effect on 1 September 2003, but was over-ruled by the Ministry of Information Society. In July 2003, as described above, Mobitel and Simobil adjusted some of their retail

tariffs. Vega filed an addendum to its complaint, assessing the adjustments and noting that they had no impact on the substance of Vega's original complaint. In December 2003, the NRA suspended its proceedings on the basis that the circumstances underpinning Vega's complaint had changed. In January 2004, Vega and the NCA requested that the NRA participate in a tri-partite meeting, to address the substantive questions relating to Vega's complaints. At that meeting, the NRA maintained the position that Vega is not a party to either proceedings and that, as such, it will not discuss the proceedings with Vega.

The NRA made no assessment of the substance of Vega's complaint. Vega filed a complaint against the NRA's suspension decision. The NRA rejected that complaint, on the basis that Vega is not a party to the proceedings against Mobitel and Simobil. Vega appealed this rejection to the Ministry of Information Society. The Ministry of Information Society annulled the decision by the NRA.

As a result of the appeal, the NRA began to evaluate Vega's legitimate interest in being included in the decision making process and/or being granted standing as a participant in the process. In doing so, it required Vega to restate its case pursuant to the new post-1 May 2004 legal framework. Vega took the position that it lodged a complaint under the old framework. Subsequent legislative change has no effect on that complaint. On 19 October 2004, the NRA issued a decision finding that Vega does not have a legitimate interest, and denying it status as a party or a participant in the proceedings. Vega is in the process of preparing an appeal to the Ministry of Information Society.

Vega understands that the NRA has not begun to develop an appropriate cost model that would allow it to address the substance of Vega's 17 April complaint or to provide expert assistance to the NCA in relation to Vega's 16 May complaint to the NCA. Vega understands that the NRA has not yet developed or acquired, or begun the process of developing or acquiring, a cost model that would allow it to assess whether Mobitel's retail tariff structure does breach the *Telecommunications Act*.

- DRAFT -
November 2004

Chronology of Events – Slovenian NCA Proceedings

Date	Parties involved	Issue	Action
16 May '03	Vega filed complaint with NCA	Alleging Mobitel's dominance and abuse	Procedure initiated
26 Jun '03	NCA	Publication of initiation; call for public comment	
1 Aug '03	Meeting of Vega – J. Coustaury and K. Grubar; NCA – Director Plahutnik and D. Muzenic	❑ Discuss Mobitel tariff changes; ❑ Status update – NCA to request temporary rulings from NRA and seek NRA's advice re cost-orientation and cross-subsidisation	Estimate from NCA that no decision before YE '03
26 Aug '03	Filing of Vega addendum to complaint	Clarifying further impact on competition of most recent Mobitel tariff changes	Vega argued that tariff imbalance worsened by changes
18 Nov '03	Vega requests meeting	Apparent lack of progress	
1 Dec '03	Meeting of Vega – J. Coustaury and K. Grubar; NCA – Director Plahutnik and D. Muzenic	❑ NCA indicates that only outstanding issue regarding dominance conclusion is confirming that the LRIC model does not justify an on-net/ off-net differential; ❑ NCA to request NRA confirm status of progress regarding LRIC model preparation ❑ NCA believes NRA requires external support to complete LRIC model	NCA to attempt to arrange meeting between Vega, NCA and NRA to address LRIC issues
5 Dec '03	Meeting of Vega – K. Grubar; NCA – D. Muzenic	❑ NCA to immediately seek NRA's opinion re Vega's position that on-net/ off-net costs are the same; ❑ NCA to address formal questions to Mobitel and NRA regarding pricing issues; ❑ NCA to consider retaining external expert(s) to review Vega's analysis	❑ NCA to arrange meeting with NRA (and possibly Vega) ❑ Vega to identify possible external expert(s)
23 Dec '03	NRA suspends own investigation and involvement in NCA investigation	NRA's act deprives NCA of access to industry expertise	Vega's position was that retention of external advisor is only way to advance

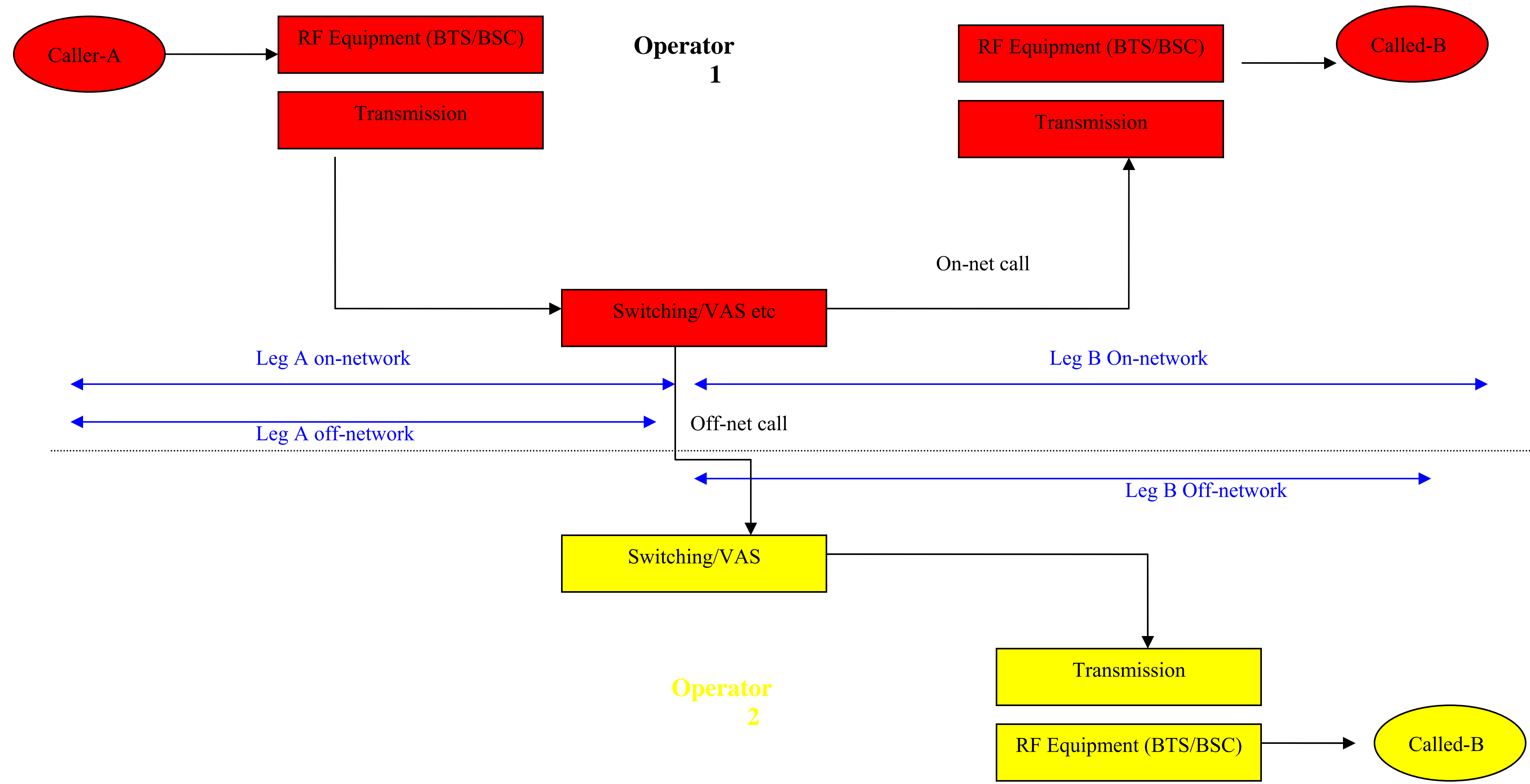
23 Dec '03	Vega advises NCA of NRA suspension of its procedure	Vega requests immediate action by NCA, in light of NRA refusal to act	
24 Dec '03	Vega	Contact potential external expert(s)	
5 Jan '04	Vega email to NCA	Vega advises NCA that it has requested a copy of the NRA's decision to suspend its procedure, explains that it is contacting potential external expert(s) and proposes a meeting to brief the external expert(s)	
8 Jan '04	Vega email to NCA	Provides review of NRA's reasons for suspending its procedure	
15 Jan '04	Meeting of Vega – J. Coustaury and K. Grubar; NCA – Director Plahutnik and D. Muzenic; NRA – Director Simic, M. Zupanic and T. Cerar	Vega requests and receives update from NRA as to its failure to take a decision in its investigation	
15 Jan '04	Meeting of Vega – J. Coustaury and K. Grubar; NCA - Director Plahutnik and D. Muzenic	Further discussion of appointment of external expert(s)	NCA indicates that it intends to issue SO on receipt of opinion of external expert
4 Feb '04	Vega correspondence with NCA	Vega provides details for possible foreign expert(s), to ensure independence	NCA rejects appointment of non-Slovene expert
26 Feb '04	NRA provides opinion to Vega	Opinion addresses only that, using benchmarks, Mobitel's wholesale rates appear to be cost-oriented	NRA asserts other matters have been indirectly answered in meetings and correspondence
3 Mar '04	Meeting of Vega – J. Coustaury, K. Grubar and R. Blott and NCA - Director Plahutnik and D. Muzenic	Discussing possible foreign external expert(s), costs and time frames	
15 Mar '04	Vega email to NCA	Inquiry regarding appointment of foreign external expert(s)	NCA response that it is negotiating with a

			possible appointee
19 Mar '04	Correspondence from Mobitel's counsel to NCA	Rejecting appointment of foreign expert; maintaining that NRA must provide relevant opinions	
26 Mar '03	Vega files further addendum to complaint	Addressing impact of latest Mobitel tariff revisions	Tariff imbalance worsened by changes
30 Mar '03	Mobitel files response to complaint	Asserting that: ❑ tariffs are cost-oriented; ❑ LRIC is not appropriate model; ❑ no cross-subsidy; ❑ financial position as good as could be expected; ❑ contractual terms are fair	
1 Apr '04	NRA provides opinion to NCA	Opinion as per 26 Feb opinion to Vega	
Apr '04	Vega inquiry to NCA	Inquiry regarding appointment of external expert and anticipated date of decision	NCA confirms that it is working on the case
21 Apr '04	NCA order to Vega	NCA requires Vega to respond to NRA opinion	
29 Apr '04	Meeting of Vega – J. Coustaury and K. Grubar; NCA – Director Plahutnik and D. Muzenic	Discussion of NRA opinion and status of NCA proceeding	
4 May '04	Vega responds to NCA	Opinion on NRA opinion and Mobitel filing	
1 Jun '04	Meeting of Vega – J. Coustaury and K. Grubar; NCA – Director Plahutnik	Discussion concerning status of NCA proceedings	
2 Jun '04	Additional filing by Mobitel	Mobitel argues that, while it is dominant, there is no abuse	
15 Jun '04	Vega calls NCA	Inquiry concerning progress and current status, seeking rapid resolution	
17 Jun '04	Vega response to Mobitel supplementary filing	Vega notes that no new arguments are made or data provided; corrects errors in source data used by NRA	
24 Jun '04	Vega calls NCA	Inquiry concerning progress and current status, seeking rapid resolution	

8 Jul '04	Vega email to NCA	Vega identifies availability of personnel in summer to assist NCA in finish the well advanced SO and proposes meeting between NCA and Vega personnel in following week	
20 Jul '04	NCA order to Vega	NCA requires Vega to provide copies of all documents relevant to NRA proceedings	
26 Jun '04	Vega files with NCA	Vega provides a summary of NRA proceedings and copies of all relevant documents and decisions (by NRA and Ministry)	
Jul '04 (various)	Vega inquiries to NCA	Vega inquiries concerning anticipated date for issue of SO	NCA indicates that the SO was to be issued in July, revising that to August and further to mid-October 2004
30 Sep '04	Vega contacts NCA to enquire as to progress in light of estimated timelines given in July '04 calls	NCA indicates that it is in contact with the Commission, and that the Commission is providing advice	SO to be issued before the end of Oct '04
10 Nov '04	Mobitel amends tariffs	Mobitel reduces off-net post-paid tariffs	
15 Nov '04	Vega files preparatory writ with NCA	Writ relates to the procedures and failure to act of the NRA, the damages claim addressed to the Government of Slovenia and the remedies Vega is seeking from the NCA	

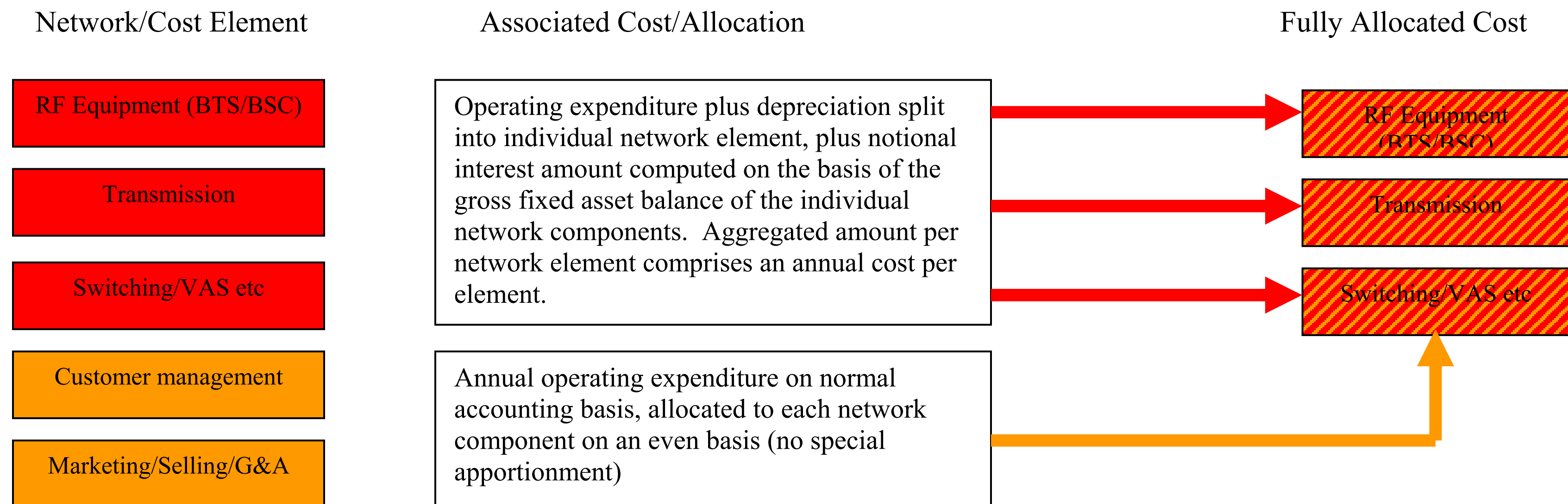
Annex 2 – Network an Cost Components

Components of call handling for on-net calls and off-net calls (to another mobile operator).



The diagram above shows the network elements used for both on-net and off-net calls. To determine the costs of each call type requires a determination of the cost and usage of each part of the network used, and the aggregation of these costs.

The costs of a mobile operator are typically broken down into units as shown below. For the network elements (*e.g.,* transmission, switching, RF equipment), a cost per network element is derived from an analysis of the operating expenditure for the service delivery, and depreciation per network element category. In addition, a notional interest return is calculated on the gross fixed assets balance on each network component category and this is included as part of the annual cost of each network component. Non-network costs are taken directly from the financial accounts and are allocated to each network element evenly (*i.e.*, in three). The result is a fully allocated cost basis for determining the cost of call completion. Note that this analysis excludes out-payments to other operators.



Allocations of costs per network element can therefore be looked at in two ways: direct cost of allocation (network direct costs only – red arrows) and fully allocated costs (red and orange arrows). Since Mobitel figures for costs are not available to Vega, a *normalised* cost base has been used to assess the *relative* costs of calling patterns. This assumes that the cost base used (direct or fully allocated) is set to a notional figure of 100 and then allocated across network elements. Furthermore, a typical network operator split derived from Western Wireless' internal resources is adopted. The following table shows the allocation of costs across network elements for a typical mature GSM network operator:

	Fully Allocated Costs				**Network Direct Costs Only**			
	Switch	**RF**	**Trans**	**Total**	**Switch**	**RF**	**Trans**	**Total**
Normalised cost base (=100)	22	39	39	100	9	50	41	100

To determine the cost of utilising the network element per call type per minute, one must determine the usage per network element per call and the mix of types of call. Mobitel's call traffic pattern has been approximated on the basis of its market share, to generate the following balance of traffic:

Outgoing on-network	77
Outgoing off-network	23
Incoming (from other networks)	23

If one then follows the call routing for each type of call one can see that of each type of call the following network elements are used:

Outgoing on-network	RF, transmission, full-switching, transmission, RF
Outgoing off-network	RF, transmission, half-switching*
Incoming (from other networks)	RF, transmission, half-switching*

A routing table for the utilisation of the network elements by call type has been built using this methodology, with the mix of traffic determining the element usage. This can be combined with the cost data to build up a cost/usage/network element which, in turn, is used to calculate the cost per call type. The calculation is shown in the following table.

* indicates that only a part of the total switching task is done by the network operator’s switch.

- DRAFT -

Typical Network Cost Allocation and Cost/Call Analysis - Normalised Basis

	Notes		**Switch**	**RF**	**Trans**	**Total**	**Switch**	**RF**	**Trans**	**Total**
Costs	1		22	39	39	100	9	50	41	100
Routing Factor	2	On-net	1	2	2		1	2	2	
		Off-net	0.5	1	1		0.5	1	1	
		Incoming	0.5	1	1		0.5	1	1	
Traffic	3	On-net	77	77	77	77	77	77	77	77
		Off-net	23	23	23	23	23	23	23	23
		Incoming	23	23	23	23	23	23	23	23
Usage	4	On-net	77	154	154	385	77	154	154	385
		Off-net	11.5	23	23	57.5	11.5	23	23	57.5
		Incoming	11.5	23	23	57.5	11.5	23	23	57.5
Total			100	200	200	500	100	200	200	500
Cost/usage	5		0.220	0.195	0.195		0.090	0.250	0.205	
Cost/call type	6	On-net	0.220	0.390	0.390	1.000	0.090	0.500	0.410	1.000
		Off-net	0.110	0.195	0.195	0.500	0.045	0.250	0.205	0.500
		Incoming	0.110	0.195	0.195	0.500	0.045	0.250	0.205	0.500
Total cost	7	On-net				77.0				77.0
		Off-net				11.5				11.5
		Incoming				11.5				11.5
						100.0				100.0

Notes:

1 Costs allocated per above analysis on a normalised basis (total=100) for both fully allocated and direct cost only basis
2 The usage per call type of the various network elements
3 The traffic pattern based on Mobitel's market share. Assumes balanced traffic with other operators
4 Product of the routing factor and the traffic pattern to determine relative total utilisation of the network elements
5 Cost of each unit of utilisation based on costs in 1 and total of 4
6 For each call type the cost of each network element used is computed (product of 5 and 2), and the total for each call type determined (in red)
7 Check to ensure that total traffic by call type (3) multiplied by cal/call type (6) adds to 100 (normalised total cost)

This analysis shows that the relative costs of the different types of call for the two methods of cost allocation are as follows:

	Fully Allocated	Direct Network Cost
Outgoing on-network	1.000	1.000
Outgoing off-network	0.610	0.545
Incoming (from other networks)	0.390	0.455

Normalising these on the basis that the off-network call cost is 100:

	Fully Allocated	Direct Network Cost
Outgoing on-network	164	183
Outgoing off-network	100	100
Incoming (from other networks)	64	83

While this is a first order approximation of the relative costs of handling a call, it is clear that the operator's own network costs per call type are significantly different depending on the type of call, and that the costs of an on-net call are significantly higher than an off-net call. While there will be variations according to traffic splits, routing factors and other factors that are not possible to identify in this analysis because of a lack of further data on Mobitel, these will be second-order effects that do not alter the basic analysis.

Analysis of Leg A and Leg B Costs of Calling

In the diagram at the start of this analysis the two ‘legs’ of a call have been identified: Leg A from caller to switching, and Leg B from switching to called party. These two Legs constitute the total costs of call completion.

Given that, in Slovenia, there is a symmetric interconnect regime, it is valid to assume that the network element costs of one operator are the same as in the other. Therefore, it is possible to compute the cost per call type from caller to called party and, from this, determine the basis for a cost-oriented tariff. The following table uses the data from the analysis above to determine the costs of Leg A and Leg B for each type of cost allocation and call:

	Fully Allocated Costs		Direct Network Costs	
	On-network	Off-network	On-network	Off-network
Costs of Leg A	0.610	0.500	0.545	0.500
Costs of Leg B	0.390	0.500	0.455	0.500
Total	1.000	1.000	1.000	1.000

Not surprisingly, this analysis shows that there is no difference between call types in terms of end-to-end cost. Since this is a first order approximation other factors will influence this. *Nevertheless, it shows that prima-facie there is no justification for a major differential between on-net and off-net tariffs.*

Annex 3

The Economic Analysis of the On-Net/Off-Net Mobile Tariff Differentials Charged by Mobitel

Martin Cave*

1. Introduction

This note is concerned with the possible anti-competitive effects of differences in the retail rates charged by mobile operators such as Mobitel for on-net and off-net mobile calls (*i.e.*, calls to other mobile subscribers who are, respectively, on the same and on a different network from the mobile caller). It concludes that, in certain circumstances, such price discrimination, carried out by a firm dominant in the retail outgoing mobile calls market, can have anti-competitive effects. From the data available to me relating to the Slovenian mobile market, it seems likely that these conditions are satisfied in relation to Mobitel.

The relevant facts on which I draw in reaching this conclusion are as follows:

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- mobile penetration in Slovenia exceeded 90% by the end of 2003.
- in the Slovenian market, shares of mobile subscribers held by Mobitel, Simobil and Vega are, respectively, 78%, 20% and 2%. These shares are relatively stable, despite the entry of Vega, the third mobile operator, at the end of 2001.
- since Simobil entered the market in 1999, Mobitel has followed a policy of differential on-net and off-net retail mobile charges; prior to August 2003, the ratio of off-net to on-net peak charges was between 1.8 and 2.8; between August 2003 and April 2004, the ratio was between 1.5 and 2.8; the ratio fell, in April 2004, to between 1.4 and 2.5 (and between 2.0 and 2.5 for the three most popular tariffs), and, in November 2004, to between 1.2 and 2.0 (for post-paid calls only).
- Mobitel and Vega have reciprocal mobile termination rates, of 11.2 euro cent per minute for peak calls, accounting for 61% of inter-operator traffic, and 3.4 euro cent per minute for off-peak calls – an average of 8 euro cent based on traffic between the networks in 2004 Q1-2.[1]
- Mobitel's post-paid on-net mobile tariffs at peak fall short of twice the above peak termination rate (*i.e.*, 22.5 euro cent) by between 5.5 and 13.5 euro cent. The significance of this calculation is discussed in Section 2, below.
- the imbalance in traffic between Mobitel and Vega is such that, in 2004 Q1-2, Vega sent 40% more call minutes for termination on Mobitel's network than it received from Mobitel for termination on its own network.

[1] Mobitel acknowledges in its Annual Report for 2003 (English language version) that there is 'an unusually low annual migration to the competition (if we compare the migration share data to those from foreign countries)' (p.3)

- in 2002, Mobitel's overall return on sales (excluding 'extraordinary activities') of 4% and return on capital employed of 5.5% are probably less than the cost of capital.[2]

[2] *See* Mobitel's Annual Report, pp.2.10. Return on sales is defined as (Net profit from ordinary activities)/(Net sales revenue); return on capital employed was calculated as EBIT/(Total Assets – Current Liabilities). In the UK, the Competition Commission, in 2002, estimated the cost of capital for mobile operators at 11.25% (Competition Commission, *Vodafone, O2, T-Mobile and Orange* (2002), para. 2.243). The Slovenian rate of return on capital employed appears to be low by international standards, and can be compared with Deutsche Bank's 2003 ROCE (before goodwill amortisation) calculations for CosmOTE - 32.9% (market share 40.6%); Telefonica Moviles - 28.4% (market share 50.4%); TIM - 45.7% (market share 45.5%); and Mobistar - 36.2% (market share 32.5%).

2. Analysis

The issue of disparities between on-net and off-net call prices has received considerable attention recently. It is often coupled with analysis of how mobile termination rates are set and the relationship between those termination rates and on-net call charges.[3]

I now describe a number of factors which, in my opinion, jointly and severally make Mobitel's adoption of its policy of differential off-net and on-net retail pricing likely to be anti-competitive. Key factors to take into account are that: 1) Mobitel's high and currently stable market share of 78% of mobile subscribers is assumed to place it in a position of 'super' dominance in a mature or saturated market; 2) the factors described below operate cumulatively in a way which weakens, and could ultimately exclude, a small competitor such as Vega; and 3) the case does not rest upon likely cost differences between Mobitel and other networks.

A *first* and major element in the situation arises from tariff-mediated network externalities. Obligations on mobile (and other) networks to interconnect ensure 'any-to-any connectivity' and eliminate what would otherwise be a crucial disadvantage of small networks – that their customers can only contact one another. However, if on-net and off-net call prices are different, then membership of a larger network can be made necessarily more attractive in two ways:

[3] An accessible summary of some of the literature can be found at P. Rey and B. Jullien 'Mobile to Mobile call termination' in *Regulatory Mobile Call Termination*, Vodafone Policy Paper No. 1 (2004) pp. 19-24, which lists other references.

- lower on-net charges will have the greater appeal to subscribers the larger the number of mobile owners which can be reached at the lower rates. A network which is significantly larger than its competitors can advertise this advantage and encourage groups of subscribers to migrate towards or stay with it. If, moreover, the largest network receives a net contribution from its rivals from terminating a balance of incoming calls, it can plough that back into lowering on-net prices, and thereby gain a competitive advantage.
- customers gain utility from receiving as well as making calls – otherwise they would not answer them. Ignoring the 'option' value or 'emergency' benefit of belonging to a mobile network, a customer's willingness to pay for such access consists of the sum of the consumer surplus he or she receives from making outgoing calls at the relevant tariff and from receiving incoming calls – at a price equal to zero under the calling party pays (CPP) arrangement operating in Slovenia and elsewhere in Europe.[4] By charging high off-net prices, a large network can deter its customers from calling those of a small network and thereby reduce the willingness of others to pay for membership of that network. Further, in a saturated market, a large network (with almost 80% of customers) is in a position to use its off-net charging differential as a barrier to customers' churning to other operators. This tactic is particularly effective in a mature market where customers, especially those contemplating churning, are well-informed.

[4] For an analysis of CPP and RPP see B. E. Hermalin and M. L. Katz, 'Sender or receiver: who should pay to exchange an electronic message?' *Rand Journal of Economics*, Autumn 2004, pp. 423-447.

Thus, tariff-mediated network externalities can be used and, appear to have been used by Mobitel, a dominant operator, to weaken or even eliminate a small competitor.

What, *secondly* are the potential implications of unequal traffic flows between Mobitel and Vega? Clearly, if reciprocal termination rates are above costs, this will transfer profits from Vega to Mobitel and give Mobitel a motive for seeking to maintain high termination rates.[5] It seems likely that termination rates, though lower than elsewhere in the EU, are still in excess of the long run incremental cost.[6] The transfer associated with below cost pricing would represent a significant drain on Vega because calls from Vega to Mobitel represent 45 % of all its (non-roamed) outgoing calls and a 40% excess of calls to Mobitel over those in the reverse direction amount to a significant proportion of Vega's total activity.

Augmenting the above considerations by more standard concepts of anti-competitive conduct, it is likely that Mobitel is *thirdly,* guilty of a margin squeeze. The combination of Mobitel's termination rates and its on-net call charges fails to allow a reasonably efficient competitor to compete with those on-net charges by providing an off-net call. This is shown by the difference between Mobitel's on-net retail calls prices at peak and its termination charge of 11.2 euro cent per minute at peak. At variously (on different tariffs) between a 4 euro cent deficit and 5 euro cent per minute, this is not large enough

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[5] The situation is similar but not identical (as the two mobile operators are competing for the same customers) to that that of two international operators seeking to agree on a settlement rate for international telephone calls. The operator with a balance of incoming calls will seek to ensure higher reciprocal rates.
[6] The New Zealand Commerce Commission cites the Ovum Mobile termination rates report, January 2004, as finding that the results of seven regulatory cost models produce a range of between approximately 6 and 10 euro cent per minute, with an average of 8 euro cent per minute, and a 75th percentile of approximately 8.5 euro cent per minute. Commerce Commission, New Zealand: Schedule 3 Investigation into Regulation of Mobile Termination. Draft Report, October 18 2004, Public version, Paragraph 389.

to allow the competitor to cover the costs of the origination of a potentially competing off-net call, let alone the billing costs.[7] As a consequence, Vega's off-net retail prices have been forced down to below its cost of origination and Mobitel's of termination, as Vega attempts to provide competitive rates for calls to Mobitel customers.

Fourthly, there is evidence (which requires confirmation by means of detailed accounting data) that Mobitel is behaving in a predatory fashion. The evidence takes the following form:

- many of Mobitel's on-net calls are tariffed at prices which are almost certainly below their long-run incremental cost (the relevant cost standard for predation in electronic communications services networks).[8]
- because most of Mobitel's mobile-to-mobile calls are on-net, it is likely that its customers' calls to mobile are loss-making in aggregate.[9]
- as noted above, Mobitel fails to earn a return on capital equal to the cost of capital on its business as a whole.

It follows from these data that Mobitel is likely to be making a loss on its retail cluster as a whole because:

[7] The costs of originating a mobile-to-mobile call exceed those of termination by a small amount, as origination involves finding the location of the mobile callee. A reasonable estimate of the cost of origination would be in excess of the termination cost reported in fn.6. It would exceed the margin of a 4 euro cent deficit and 5 euro cent, reported above. Vega estimates that the cost differential between origination and termination is 17%.
[8] This conclusion is based on a comparison of the retail price of on-net calls and the cost of an on-net call, which comprises the cost of termination (likely to be about 8 euro cent on average), the greater cost of origination (see above) and retailing costs.
[9] By way of illustration if revenues for on-net calls – 80% of the total supplied – fall short of their costs by 30%, revenues from the remaining 20% of off-net calls would have to exceed their costs by 120% to equate revenues and costs overall, corresponding to an off-net/on-net retail price ratio of 3.1, greater than that exhibited by any Mobitel tariff.

- it is loss-making as a whole.
- its wholesale businesses, consisting largely of mobile termination and international wholesale roaming, are likely to be profitable.
- hence, its retail cluster is highly likely to be loss-making.[10]

Moreover, Mobitel's most recent (November 2004) price changes, which have cut off-net mobile prices to a flat rate of approximately 16 euro cent per minute, have slightly diminished the ratio of off-net to on-net call charges, as reported in Section 1 above, but have - other things being equal - exacerbated the company's apparent predatory conduct.

Fifthly, Mobitel’s on-net and off-net prices are discriminatory, as calls with the same costs (termination in the case of on-net calls being self-supplied, in the case of off-net calls being provided by another operator) are charged at different prices in a manner having anti-competitive consequences.

Conclusion of the analysis.

Given the facts assumed in Section 1, I conclude that Mobitel’s conduct in respect of setting on-net and off-net retail mobile call charges is likely to be anti-competitive, for the following reasons:

[10] The point can be made formulaically as follows: Profitability overall (-ve) = wholesale profitability (+ve) + Retail profitability (necessarily –ve). Moreover, retail profitability includes on-net mobile calls profitability (-ve) and handset subsidies (-ve). The full calculations should, of course, take account of costs which are common to Mobitel's retail and wholesale markets and be expressed in a forward-looking way.

- the effect of Mobitel's differential charges is to create tariff-mediated network externalities which disadvantage Vega;
- in the case that Mobitel's reciprocal termination rates exceed LRIC, they have the effect of transferring resources from Vega to Mobitel as a result of traffic flow imbalances created and sustained by the tariff-mediated network externalities;
- on reasonable assumptions about the cost of originating mobile telephone calls, Mobitel is practising a margin squeeze between its termination rate and its on-net retail prices;
- Mobitel’s retail call prices can be construed as predatory and its on-net and off-net prices can be deemed to be discriminatory, where the effect of both types of behaviour is accentuated by the above-noted tariff-mediated network externalities.

3. Possible remedies

As noted above, the anti-competitive conduct in this case is both defined and aggravated by a combination of Mobitel's high market share, its apparently deficient profitability (both in relative and absolute terms) and its high ratios of off-net to on-net pricing.

In these circumstances, the most direct and effective remedy is to allow the dominant operator, when setting its off-net and on-net retail tariffs, to diverge only by an amount which represents difference in costs. For these purposes, the termination costs of an off-net and of an on-net call should be defined as the reciprocal termination charges. This remedy eliminates the possibility that Mobitel will be able to exploit its tariff-mediated

network externalities in an anti-competitive way; it also eliminates price discrimination and cross-subsidy.

In addition, it may be necessary to impose a condition preventing a margin squeeze by Mobitel, which would allow it to set its on-net and off-net retail tariffs in a way which excludes or weakens competitors in the market. Under this remedy, Mobitel's on-net tariff would have to exceed Mobitel's mobile termination rate by an amount which covered the incremental network and retail costs of call origination.[11]

Finally, these remedies might give mobile operators in Slovenia a common interest in raising mobile termination rates above the competitive level. This outcome can be prevented by action taken by the national regulatory authority under the 2002 Directives on electronic communications services.

Appendix : curriculum vitae of Martin Cave

[11] Alternatively, as an interim measure, a mark-up of 50% above Mobitel's termination rate for Mobitel's on-net tariffs should serve as a proportionate response, in the absence of full information about Mobitel's costs.