

Vodafone Limited; and

(b) if so, whether the effects adverse to the public interest which those levels of charges have or may be expected to have could be remedied or prevented by modifications of the conditions of the licence granted to BT under section 7 of the Act on 22 June 1984.

The report on this reference shall be made within a period of six months beginning with the date of this reference.

5 March 1998

(signed)

DON CRUICKSHANK

*Director General of Telecommunications*

2. On 13 July 1998 it was announced that the DGT had agreed to an extension until 4 December 1998 of the time allowed for the reports on these references. The announcement said that the reporting period had been extended because the issues raised by the inquiry were more wide-ranging than was the case when a specific licence modification for an individual operator was in dispute and because the MMC wanted to examine the underlying conditions of competition relevant to calls to mobiles and to have time to consult fully on any licence conditions it might consider necessary.

3. On 12 March 1998 the Chairman of the MMC, acting in pursuance of section 13(9) and (10) of the Telecommunications Act 1984, directed that the functions of the MMC in relation to the references relating to Cellnet and Vodafone should be performed through a Group of five members of the MMC. He appointed himself, being a member of this Group, to act as Chairman of the Group. The composition of the Group of members which was responsible for the investigation and report is indicated in the list of members in the preface. The same Group of members was also responsible for the reference relating to BT.

4. The investigations for all three references were conducted in parallel. Much of the evidence submitted including evidence given at hearings with the MMC related to all three references.

5. Notices inviting interested parties to submit evidence to the MMC were placed in The Financial Times, What Mobile and Cellphone Magazine, What Cellphone and Mobile Choice.

6. In addition, evidence and views were sought from a number of telecommunications operators and service providers, Telecommunications Advisory Committees, Consumers' Association and various other bodies representing consumers' interests, local authority associations, the Trades Union Congress, the Confederation of British Industry, the Radiocommunications Agency, handset manufacturers, retailers and distributors, members of the Large Business Telecommunications User Panel and other interested parties. Evidence was received from a number of these and from private individuals. This evidence is summarized in Chapter 9 and in other parts of the report.

7. Vodafone and Cellnet each provided several written submissions and also attended two hearings in

addition to a joint hearing which also involved the DGT, BT, Orange, One2One and representatives of the Telecommunications Advisory Committees. Members of the Group and staff also made visits to the headquarters of Vodafone, Cellnet, BT, Orange and One2One.

8. Two hearings each were also held by the Group with Orange, One2One and BT, and single hearings were held with AT&T Communications (UK) Ltd, BAA Plc, Cable & Wireless Communications, Consumers' Association, Energis Communications Ltd, Ericsson (UK) Ltd, John Lewis Partnership, Motorola Tel Co, Telecommunications Users' Association, Telewest Communications Plc, UniqueAir Ltd, WorldCom International Ltd and Blah Publishing Ltd. Three hearings were also held with the DGT (in addition to the joint hearing referred to in paragraph 7). Staff meetings were held with OFTEL, BT, Cellnet, Vodafone, Orange and One2One on various issues.

9. Some of the evidence obtained during the course of the inquiry was of a confidential nature and the report contains only such information as is considered necessary for a proper understanding of its conclusions.

10. The MMC would like to thank all those who helped in our inquiries, particularly the DGT and the representatives of Cellnet, Vodafone, BT, Orange, One2One and OFTEL.

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## APPENDIX 2.1

(referred to in paragraphs 2.396, 2.398, 9.15 and 9.33)

Interconnection Directive: views submitted on behalf of Cellnet, Vodafone, OFTEL, One2One and European Commission Services

### Cellnet

1. Cellnet submitted that the powers of the DGT to intervene on any question related to interconnection were entirely governed by the Interconnection Directive (the Directive), ie interconnection was a field occupied by EC law. This was evident from the recitals to the Directive and the Directive itself. The existence of the Directive precluded the operation of national law which was inconsistent with the Directive or which created exceptions or derogations to its object of harmonizing the rules across the EU. The DGT, in exercising his powers under the Telecommunications Act 1984, was required by EC law, and the terms of the European Communities Act 1972, to act in a manner consistent with the Directive. Cellnet did not believe that the Directive allowed intervention by the DGT or any other public authority on Cellnet's interconnection charges in the present circumstances.

2. Cellnet argued that the Directive sets up a limited regime for national regulatory authorities (NRAs) to intervene in the charges set in interconnection agreements. These provisions are contained in Article 7 of the Directive. Article 7(1) limits the operation of these provisions to '... organisations operating the public telecommunications networks and/or publicly available telecommunications services as set out in Parts 1 and 2 of Annex I, which have been notified by national regulatory authorities as having significant

market power'. Parts 1 and 2 of Annex I related to fixed public telephone networks and leased lines services respectively. Public mobile telephone networks appeared under Part 3 of Annex I and Cellnet submitted that it was clear that they had been deliberately withdrawn from the main operation of interconnection charge regulation under Article 7. Exceptionally, the scope of Article 7(2) was extended to organizations set out in Part 3 of Annex I (ie mobile operators) but only if they 'have been notified by national regulatory authorities as having significant market power on the national market for interconnection'. Cellnet had not been so notified.

3. Cellnet went on to refer to Article 9(3), which provides:

In pursuit of the aims stated in paragraph 1, national regulatory authorities may intervene on their own initiative at any time, and shall do so if requested by either party, in order to specify issues which must be covered in an interconnection agreement, or to lay down specific conditions to be observed by one or more parties to such an agreement. National regulatory authorities may, in exceptional cases, require changes to be made to interconnection agreements already concluded, where justified to ensure effective competition and/or interoperability of services for users.

Cellnet said that Article 9(3) thus conferred an ex-ante, and ex-post, power to regulate interconnection agreements. The ex-ante (in advance) power (in the first sentence of the provision), which was exercisable by NRAs on their own initiative and at the request of parties, included the power to specify conditions relating to, inter alia, tariffs to be included in interconnection agreements. The ex-post (after the event) power (in the second sentence of the provision) was one exercisable '... in exceptional cases' and was further limited to situations where interference was justified to 'ensure effective competition and/or interoperability of services for users'. Article 9 thus conferred only a very limited power of intervention (if any) as to price beyond that conferred by Article 7. Where express powers were conferred, as under Article 7, it would be a heterodox interpretation under EC law to allow Article 9 to confer a power at large. Article 9(3) expanded the powers only in exceptional circumstance and even then only where necessity was established.

4. So far as concerns interconnection charges, Cellnet considered that the power of national regulatory authorities under Article 9(3) was simply to ensure that the charges specified by existing and prospective agreements conformed with Articles 6 and 7 and to require changes if they did not.

5. Cellnet believed that the view that interconnection charges for mobile operators were to remain unregulated was supported by a recent Communication of the European Commission on interconnection pricing:

The cost of call termination on a mobile network is in most cases not subject to price regulation under the Interconnection Directive. The one exception occurs if the mobile operator is designated by its NRA as having significant market power on the national market for interconnection (ie the fixed market for interconnection and the mobile market for interconnection combined). In this connection, the Commission has made the following statement to the European Parliament:

The Commission confirms that Article 7(1) of the Interconnection Directive is to be applied to all organisations operating the public telecommunications networks and/or publicly available telecommunications services as set out in Parts 1 and 2 of Annex [ie fixed network operators], which have been notified by national regulatory authorities as having significant market power, and only to those organisations.

The implications of this statement are that the Commission does not support on the basis of the Interconnection Directive a general obligation for cost oriented interconnection tariffs on mobile operators that do not have significant market power on the national market for interconnection. This is without prejudice to the duty of Member States and of undertakings to fully comply with EU competition rules, taking account of the specific positions set out in the Communication from the Commission on the application of the competition rules to access agreements in the telecommunications sector.

6. Cellnet said that the Commission's view was highly persuasive and the European Court of Justice, when construing the Directive, was likely to pay close attention to it. The Commission was emphasizing that the only rules to which mobile operators without significant market power on the national market for interconnection were subject were the general EC competition rules. This was quite consistent with the principles set out in the recitals to the Directive. The Commission was plainly not supporting the contention that NRAs retain residual regulatory powers at the domestic level since (a) this would be clearly wrong as a matter of EC law; and (b) if the Commission did support such an important and novel proposition, it would have clearly said so.

7. Cellnet also referred to Article 3.1 of the Directive, which provides:

Member States shall take all necessary measures to remove any restrictions which prevent organizations authorized by Member States to provide public telecommunications networks and publicly available telecommunications services from negotiating interconnection agreements between themselves in accordance with Community law. The organizations concerned may be in the same Member State or in different Member States. Technical and commercial arrangements for interconnection shall be a matter for agreement between the parties involved, subject to the provisions of this Directive and the competition rules of the Treaty.

It said that this required charges to be governed by agreement between the parties subject only to limited derogations provided for expressly in the Directive itself and Articles 85 and 86 of the EC Treaty.

### **Vodafone**

8. Vodafone argued that in considering the questions referred to them, the MMC should approach the matter by reference to the policy and objects of the Directive. It was clear that, as a matter of public policy (which was to inform the activities of the national regulatory authorities), the Directive envisaged that mobile network operators whose market position fell short of a position of significant market power in the national market for interconnection should not be subjected to a general obligation to offer cost-orientated prices. This reflected a policy decision that the promotion of mobile networks would best be achieved through allowing mobile network operators full flexibility in the setting of their prices through negotiation, subject only to the competition provisions of the EC Treaty and to the provisions of the Directive itself. Observance of this policy decision should inform the MMC's judgment as to whether the present pricing arrangements operate against the public interest at all. This did not mean, however, that there was no possibility of the MMC's making findings of adverse effect, and recommending remedies to deal with the adverse effects which they identified provided that those findings and remedies were compatible with the Directive.

9. Vodafone argued that because the Directive was intended to provide a comprehensive, and mandatory, regime for the regulation of interconnection arrangements (subject only to the limited discretion permitted

under the Directive), it was not open to the DGT, by the making of licence modifications in accordance with sections 12 to 15 of the Telecommunications Act or otherwise, to create a new set of regulatory rules to govern interconnection to Vodafone's network, which was either different from, or going beyond, what the Directive allowed and required. To that extent, the general regulatory powers conferred on the DGT under the 1984 Act were constrained by the obligations imposed on the UK under the Directive.

10. It argued that it would be inconsistent with the regulatory regime established by the Directive for a member state to introduce rules for the comprehensive regulation on a cost-oriented basis of interconnection charges levied by mobile network operators, when the Directive clearly contemplated that mobile operators' charges should be so regulated only in circumstances where they enjoyed significant market power in the national market for interconnection. It was clear that the terms of Article 7.2 of the Directive deliberately excluded the possibility that mobile network operators should generally be required to adhere to regulated cost-reflective prices in the setting of their interconnection charges. Vodafone referred to the European Commission Communication set out in paragraph 5 above.

11. Vodafone also argued that Article 3.1 of the Directive (see paragraph 7 above) required charges to be governed by agreement between the parties, subject to the Directive and EC competition law.

12. Vodafone argued, moreover, that it was not open to the MMC, if they found that the matters referred to them in respect of Vodafone's interconnection charges operated against the public interest, to specify (by way of remedy) modifications which it would not be open to the DGT to make.

## **OFTEL**

13. OFTEL argued that, while the DGT must exercise his powers under the Act consistently with the Directive, there was nothing in the Directive which precluded the exercise by the DGT or the MMC of their respective powers under the Act in the present case.

14. The Directive was based on Article 100a of the EC Treaty which authorized the Council, subject to the conditions set out therein, to adopt the 'measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market'. According to Article 7a of the EC Treaty, the internal market comprised an area without internal frontiers in which, inter alia, the free movement of services was ensured in accordance with the provisions of the Treaty. A directive under Article 100a did not necessarily require total uniformity of rules in all member states. Whether particular provisions of a directive under Article 100a left member states with any discretion to apply rules additional to or different from those specified in the directive would depend upon the interpretation of the directive in question. OFTEL considered there was no implied prohibition on an NRA using domestic powers to intervene in circumstances outside Articles 7 and 9(3) of the Interconnection Directive.

15. OFTEL argued that although the Commission's Declaration to the European Parliament (set out in paragraph 5 above) might be interpreted to mean that the principles of Articles 7(2) to (6) were to be applied only to operators who fell within the scope of Parts 1 and 2 of Annex I and not to operators outside that scope unless they had significant market power on the national market for interconnection as envisaged by Article 7(2), that was not what the Declaration actually said. The Declaration merely confirmed that Article 7(1) was to be applied only to operators within Parts 1 and 2 of Annex I and having significant market power. In any event, whatever the intended meaning of the Declaration, such a

Declaration could not affect the scope of the Directive.

16. The important question was therefore whether there were provisions elsewhere in the Directive that prohibited, either expressly or by implication, an NRA applying the principle of cost orientation in Article 7(2) to a mobile operator, save in the specific circumstances referred to in Article 7(2) itself. In OFTEL's view there were not.

17. OFTEL argued that NRAs were given wide discretionary powers pursuant to Article 9 of the Directive. Those powers were in pursuit of aims which were very broadly expressed in Article 9(1). The powers in question were not in any way limited so as to be exercisable only in relation to operators with significant market power. Nor did they exclude intervention in relation to charges for interconnection: from the powers expressly granted to NRAs pursuant to Article 9, it was plain that the Directive readily contemplated intervention by NRAs to specify conditions as to charges in interconnection agreements, for operators other than those with significant market power. Thus Article 9(3) specifically provided that NRAs might intervene 'on their own initiative' and 'at any time' in order to lay down 'specific conditions' to be observed in an interconnection agreements, and that such conditions may include 'tariffs'. Clearly therefore there was no objection in principle to NRAs intervening to specify interconnection charges and such intervention was not limited to operators with significant market power nor to exceptional circumstances.

18. This did not produce a strange result. The scheme of the Directive was that certain matters were so important that they were the subject of precise mandatory obligations placed on member states (for example, cost orientation in respect of the organizations within the scope of Article 7); however, the imposition of precise mandatory obligations did not deprive NRAs of their general responsibilities, and even if it did, the Directive expressly required NRAs to pursue the aims set out in Article 9(1) by using the powers set out in Article 9(3).

19. In any event, OFTEL considered that the present case was an exceptional case for the purposes of the second sentence of Article 9(3), where intervention was justified to ensure effective competition. It did not consider that a narrow meaning should be given to the words 'to ensure effective competition'. The lack of effective competition was a justification for intervention under Article 9(3) and the DGT, and the MMC, would be entitled to find the existence of an exceptional case by reference to the wide range of aims that the NRAs are required to pursue.

20. As to the effect of Article 3(1), OFTEL argued the imposition of conditions as to charges were not restrictions within the meaning of Article 3(1), and the last sentence, requiring commercial arrangements for interconnection, to be a matter of agreement, was subject to the provisions of the Directive, including Article 9.

### **One2One**

21. One2One argued that the Directive did not support the imposition of cost-based interconnection pricing on mobile operators unless they have significant market power in the national market for interconnection and that this was the view of the European Commission. It too referred to the passage in the Commission Communication set out in paragraph 5 above. It also pointed out that the DTI's Implementation of the Interconnection Directive Consultation Paper dated October 1997 states that

‘... Article 7(2), which says that charges for interconnection should be transparent and cost-orientated, can only be imposed if a mobile operator is judged to have SMP on the national market for interconnection’. Butterworths’ journal on Telecommunications Laws in Europe confirmed this view and explained the rationale behind it: ‘This national market for interconnection encompasses both the fixed and mobile telephone market in a Member State. As a consequence, the operators of mobile telephone networks and services enjoy the privilege that their respective market position is assessed with reference to the (broad) market for interconnection (and not with reference to the narrower mobile market) whereas the market position of providers of fixed telephone networks and services ... is determined with reference to their respective markets. The rationale for this privilege ... is to enable mobile operators to strengthen their market positions as competitors of the incumbent fixed network operators’.

22. It argued that the imposition on all mobile operators in the UK of a requirement for cost-orientated inbound termination rates would place mobile operators in the UK at a significant disadvantage in comparison with mobile operators in other EU member states. If OFTEL’s proposals were implemented One2One or another UK mobile operator with no significant market power either in the mobile market or in the national market for interconnection would nevertheless have to offer mobile operators in other EU member states cost-orientated interconnection but would have to pay such mobile operators whatever they required (or was determined by the relevant NRA in the absence of agreement). There was clearly no requirement for an NRA in another member state to impose cost-orientated termination rates in these circumstances. This meant that there was clearly scope for significant distortion of competitive conditions of the kind which the Directive and the other Open Network Provision directives were intended to eliminate, and OFTEL’s proposals were not, therefore, compatible with the single market aims of the Directive.

23. One2One also argued that the Directive required that any regulation be on the basis of actual costs, not deemed costs. Although the recitals to the Directive indicated that charges for interconnection based on a price level closely linked to the long-run incremental cost of providing access to interconnection were appropriate for encouraging the rapid development of an open and competitive market, it also stated that the level of charges should not be below a limit calculated by the use of long-run incremental cost and cost allocation and attribution methods based on actual cost consideration, nor above a limit set by the stand alone cost of providing the interconnection in question. One2One believed that the requirement that charges should not be below a level based on actual costs (although applicable primarily to the fixed sector rather than to mobile operators) was a recognition that setting interconnection charges at too low a rate would deter sustainable market entry and therefore prevent the development of competition.

24. One2One considered that the remedies proposed by the DGT would be incompatible with the general responsibilities of NRAs, under Article 9 of the Directive.

### **European Commission Services**

25. Officials of the European Commission sent a document (set out below) providing the views of the Commission Services (including the Legal Service) on the points raised by the MMC. It was emphasized that the views expressed were not a formal opinion of the Commission, nor were they intended to be taken as a determinative interpretation of EC law.

The MMC asks whether, under Community law, it would be permissible for the licences of Cellnet and Vodafone to be modified in order to impose some form of price control on the interconnection charges for termination of calls on their respective networks.

1. The ONP [Open Network Provision] framework provides a set of harmonised rules addressed to Member States, in the telecommunications sector. In this context, the ONP Interconnection Directive 97/33/EC provides a harmonised regime for the regulation of interconnection within the Community, under which organisations with rights and obligations to interconnect are defined, rules concerning non-discrimination and transparency are laid down, the principles for cost-oriented interconnection charges and cost-accounting systems are set out, and the responsibilities of the national regulatory authorities are established.

2. According to Article 7(2) of the Interconnection Directive, the only circumstance in which cost-oriented interconnection charges are required to be imposed on mobile operators is where they are notified as having significant market power on the national market for interconnection. The national market for interconnection is described in the Commission Communication on interconnection pricing as 'the fixed market for interconnection and the mobile market for interconnection combined'.

3. The Interconnection Directive does not explicitly prohibit the imposition of some form of price control on interconnection charges of mobile operators that do not have significant market power on the national market for interconnection. In this regard, the Commission made a statement to the European Parliament during the course of the adoption of the Interconnection Directive, that was subsequently amplified in the above-mentioned Communication on Interconnection Pricing, to the effect that the Commission 'does not support on the basis of the Interconnection Directive a general obligation for cost-oriented interconnection tariffs on mobile operators that do not have significant market power on the national market for interconnection'. On the basis of Article 3(2) of the Licensing Directive 97/13/EC, a general obligation of this nature could be considered not to be proportionate to the aims pursued.

4. The imposition, on a case-by-case basis and following a specific investigation, of some form of price control on interconnection charges of individual mobile operators that do not have significant market power on the national market for interconnection is not precluded. National regulatory authorities (NRAs) are specifically empowered to do this on the basis of paragraphs 1 and 2 of Article 9(3) of the Interconnection Directive. Article 9(3) requires that Member States' legislation allows their NRA to intervene on its own initiative at any time to set interconnection conditions (for example through amendment of licensing conditions), including conditions on tariff principles. However, the NRA must take account of the principle of non-discrimination if the licences of only a limited number of undertakings are being changed, and must be able to

demonstrate that its intervention is 'in pursuit of the aims stated in paragraph 1' of Article 9 (maximising economic efficiency, stimulating a competitive market, maximising benefit to end users, etc). Moreover, such intervention by an NRA must be proportionate to the identified problem and to the aim pursued, and be in accordance with all other applicable provisions of Community Law. In particular, account has to be taken of the possibility of tackling excessive prices under competition law, and of the fact that imposing a permanent price control might be disproportionate to address a temporary problem.

5. Action by NRAs must take due account of the competition rules of the Treaty. The Commission has published a Notice on the applications of competition rules to access agreements in the telecommunications sector, that sets out the relationship between sector specific regulation and the competition rules. In particular, the Notice draws attention to the Ahmed Saeed judgment of 11 April 1989 of the European Court of Justice, as a consequence of which NRAs may not impose or encourage pricing practices contrary to Article 85(1) or Article 86 of the Treaty. Price regulation must not be applied to operators in a competitive market in a way that forecloses the possibility of price competition between operators.

6. As far as it would comply with the above principles, the imposition of some form of price control on interconnection charges of individual mobile operators by an NRA acting under the provisions of Article 9(3) of the Interconnection Directive does not contradict the provisions of Article 3(1) of the Directive. Article 3(1) states that 'technical and commercial arrangements for interconnection shall be a matter for agreement by the parties involved, subject to the provisions of this Directive ...'. There are several provisions of the Directive that limit the freedom of negotiation set out in Article 3(1), including the provisions in Article 9.

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***ATTACHMENT 2***



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AirTouch Communications  
Submission to:

Mergers and Monopolies Commission

Reference under Section 13 of the  
*Telecommunications Act*  
entitled "Calls to Mobiles" (dated 5  
March 1998)

June 1998

## 1. INTRODUCTION

AirTouch™ Communications ("AirTouch") would like to take this opportunity to provide its comments to the United Kingdom's Mergers and Monopolies Commission ("MMC") in response to the Referral of 5 March 1998 from the Office of Telecommunications ("OfTel"), regarding "Prices of calls to mobile phones".

In particular, AirTouch wishes to share with the MMC the benefits of its broad international experience in the mobile sector, especially by providing some observations based on its U.S. wireless experience and some overview data concerning the price of mobile services in parts of Europe outside of the United Kingdom. AirTouch is arguably the world's largest global wireless communications company, with ownership interests in mobile service providers in the United States, in six European Union Member States and mobile communications interests in six other countries.<sup>1</sup> We feel that this breadth of experience can be of particular interest to the MMC in its determination of an issue such as whether interconnection charges between fixed to mobile networks, and vice versa, are "excessive" at any given point in time.

In summary, as demonstrated below, at least in the case of termination charges for fixed to mobile calls, the level of pricing reflects the relative maturity of the market and a series of economic variables whose genesis is far removed from that which characterises termination charges on incumbent fixed line networks.

Both the architecture and the economics of fixed line networks are fundamentally different to mobile networks. Moreover, unlike the incumbent fixed line operator in any given Member

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<sup>1</sup>The operators within the European Union in which AirTouch has an interest are AirTel (Spain), Telecel (Portugal), Omnitel Pronto Italia (Italy), Mannesmann Mobilfunk/D2 (Germany), Europolitan (Sweden) and Proximus/Belgacom Mobile (Belgium). AirTouch also has interests in mobile telephone businesses in Poland, Romania, Japan, Korea and India. In the United States, AirTouch provides mobile telephone service to over 4 million customers.

State, mobile operators do not exercise any relevant "market power" relative to the completion of calls on their networks. The completion of calls on mobile networks is not tantamount to the provision of a bottleneck facility. Indeed, the very high degree of the churn in most European markets suggest that the transaction costs faced by consumers in changing operators are minimal, thereby acting as a strong counterweight to any single mobile operator being considered to hold significant market power. Consequently, there is a very serious risk that an attempt to transpose a regulatory model developed over many years in the fixed line environment to the mobile sector will be fundamentally flawed. The decision to exempt mobile operators from ONP rules under the Community legal framework, coupled with the definition of the "market for interconnection" for calls to mobiles under the EU's *Interconnection Directive* of 1997, supports the view that there is no 'natural monopoly' in the termination of calls to mobile networks.

The data cited by AirTouch supports the conclusion that competition is currently consistently providing European consumers with falling prices and a greater range of options. These two trends, in our view, support an irresistible case that regulatory intervention is at present unnecessary because there is no residual market failure. The injection of new competition in many Member States through the granting of DCS-1800 licences, and the foreseen introduction of UMTS licenses, will exert even greater pressure on mobile tariffs.

In closing, it should be pointed out that the policy debate throughout the liberalised world is towards less regulation, with an increasing emphasis on the application of competition rules. The European Commission's general review of the regulatory framework as part of its "1999" review carries this message as one of its central themes. Seen in this light, and assuming the absence of collusion, regulatory intervention which envisages the setting of tariffs in a highly competitive market would

appear to be running directly counter to that regulatory momentum.

## 2. COMPARISON OF U.S. AND EUROPEAN PRICING AND INTERCONNECTION PRACTICE

Chart I overleaf compares the methods used to develop both the retail price of a fixed-mobile call and the interconnection charges exchanged by fixed and mobile operators in the U.S. and Europe. The most notable feature of the U.S. market is that, even where "Calling Party Pays" arrangements are used, determination of the retail price is completely separate from determination of the interconnection charge. In this way, mobile operators set the retail charge for fixed-mobile calling in response to market demand. Customers can benefit from a wide variety of discounts, promotions, price specials, and innovative price plans. In the European Union, mobile operators are constrained from offering such discounts and promotions to the full degree possible in a competitive market. The source of this constraint is that the price of a fixed-mobile call is linked to the interconnection charge, which is developed through complex negotiations and cannot be changed either quickly or unilaterally.

AirTouch believes that interconnection arrangements should continue to be negotiated on a commercial basis. However, the retail price of a fixed-mobile call should be set by the mobile operator and set independent of interconnection charges to the fixed operator. For example, a significant impact on the overall mobile pricing package in many Member States is derived from the particular national regulatory tradition or industry practice regarding the subsidisation of handsets; particularly at the early stages of market penetration, competition on handset prices can be the key business driver from the consumer's viewpoint. Interconnection charges are thus not the sole determining factor for the level of mobile retail tariffs, but merely one of a

number of factors which are taken into account by a mobile operator in the development of its overall pricing strategy. This type of flexibility would allow mobile operators to continue to be able to use price as a marketing tool, as is customary practice in a competitive market, and to bring additional benefits of competition to a fixed-mobile caller. More advanced telecommunications applications should in principle reflect the type of tariff flexibility reflected in the mobile sector rather than the rigid price structures of the fixed line environment.

Chart I(i): Comparison of Retail Pricing Practices in U.S. and Europe

<b>Mobile Pricing Practices in the United States</b>	<b>Mobile Pricing Practices in Europe</b>
<p><i>Fixed-Mobile Incoming Calling:</i></p> <ul style="list-style-type: none"> <li>• Mobile subscriber pays for incoming call; price set by mobile operator.</li> <li>• Interconnection practices divorced from mobile operator's pricing decisions.</li> <li>• "Calling party pays" is slowly being introduced, but mobile operator will retain flexibility to set fixed-mobile prices and pay a separately determined amount to cover fixed operator's costs of billing.</li> </ul>	<p><i>Fixed-Mobile Incoming Calling:</i></p> <ul style="list-style-type: none"> <li>• "Calling party pays" is general rule; otherwise, practices vary. Generally, inbound prices are set by the mobile and fixed operators through complex negotiations.</li> <li>• In some cases, similar prices for fixed-mobile calls are imposed on all operators, significantly impeding competition in fixed-mobile pricing.</li> <li>• Continues historical practice of combining interconnection and retail prices in a single negotiated arrangement.</li> </ul>
<p><i>Mobile-Fixed Outgoing Calling:</i></p> <ul style="list-style-type: none"> <li>• Mobile subscriber pays for outbound calling. As with the price of inbound calling, mobile operator sets price to respond to competitive market.</li> </ul>	<p><i>Mobile-Fixed Outgoing Calling:</i></p> <ul style="list-style-type: none"> <li>• Same as U.S.: mobile subscriber pays for outbound calling; price set by mobile operator in response to competitive market forces.</li> </ul>

Chart I (ii): Interconnection Pricing Practices in the U.S. and Europe

Mobile Pricing Practices in the United States	Mobile Pricing Practices in Europe
<p><i>Fixed-Mobile Interconnection:</i></p> <ul style="list-style-type: none"> <li>• Fixed and mobile operators provide “mutual compensation”: mobile operators are entitled to receive the same charge for call termination as that paid to the fixed operator.</li> <li>• Interconnection is divorced from retail practices of mobile operators. Mobile operators’ costs of call termination are not considered.</li> </ul>	<p><i>Fixed-Mobile Interconnection:</i></p> <ul style="list-style-type: none"> <li>• Fixed-to-mobile interconnection integrally related to fixed-to-mobile retail price.</li> <li>• Interconnection practices vary. Some countries have a regulator and operators set amount retained by fixed operator; others have a fixed amount forwarded to mobile operator; others establish a fixed percentage for revenue division.</li> </ul>
<p><i>Mobile-Fixed Interconnection:</i></p> <ul style="list-style-type: none"> <li>• Mobile operator pays negotiated charge to fixed operator, pending determination of charges based on fixed operator’s costs. Fixed operator required to offer cost-oriented, non-discriminatory rates.</li> </ul>	<p><i>Mobile-Fixed Interconnection:</i></p> <ul style="list-style-type: none"> <li>• Regulator requires fixed operator to publish non-discriminatory, cost-oriented tariffs.</li> </ul>

### 3. THE OPTIMAL REGULATORY FRAMEWORK PROVIDES CONSUMERS WITH THE BENEFITS OF COMPETITION FOR ALL TYPES OF MOBILE CALLS

It is widely acknowledged that current US practices facilitate pricing flexibility in response to consumer demand, thereby encouraging fixed-mobile incoming traffic.

- Unlike a fixed line incumbent operator, mobile operators have no incentive to charge excessive prices for fixed-mobile calling. Excessive fixed-mobile prices would lead to lower inbound usage, less revenue, and less growth for the mobile operator.
- Mobile operators compete with other networks and have incentives to increase traffic flows on their networks, including incoming traffic. Networks which are attractive to incoming callers are more useful and likely to gain more subscriptions from called parties.
- In order to accomplish this, prices will fluctuate in response to demand. In a competitive market, prices are not set at a fixed margin relative to costs. Rather, prices are used as a marketing tool to attract different customer segments with different demands.

Solutions that impose the same price for all fixed-mobile calls regardless of the mobile network involved eliminate consumer options and effectively destroy price competition.

- There are some who apparently believe that consumers will be better protected by regulatory mandates to set a uniform rate for fixed-mobile calls, because there is insufficient competition. This proposition is inconsistent with the competitive nature of the mobile sector. Competition fundamentally requires that competing operators use price as a means of differentiating themselves from competitors.
- Even if one were to proceed on the assumption that competition is not as yet fully developed, interventionist pricing measures would eliminate the opportunity for competition to develop in response to market demand, and would stifle the development of mobile networks as a competitive force to fixed networks. Looking forward to the UMTS generation, this loss of competitive edge *vis a vis* fixed networks would decrease incentives to invest in UMTS.

**IN A COMPETITIVE MARKET, MOBILE OPERATORS SET PRICES IN  
RESPONSE TO CUSTOMERS, NOT COSTS**

In a competitive market, mobile operators must respond to differing demands from different consumers by developing innovative marketing tools. The key marketing tool which serves as an important competitive differentiator is, of course, price. End user tariffs are usually made up of price packages which do not break down the global price into numerous discrete service elements. This multi-faceted pricing is achieved by a number of means. These means include the design of a wide variety of rate plans, the offering of discounts, promotional rates, and other incentives. It is through these varied rate plans and discounts that the benefits of competition are passed on to consumers.

Mobile operators must also have the freedom to design rate plans and market services so as to best ensure the recovery of significant up-front costs and attract additional capital investment, since they must also compete with other operators for capital investment. Unlike a fixed line incumbent operator, mobile operators therefore cannot set prices simply by looking at the cost of any particular service element. Competitive mobile pricing is not simply reflected in the sum of separate prices for discrete elements. Rather, mobile prices reflect a subtle weighting process which takes into account at least the following factors:

- how to attract and retain customers by offering prices low enough to encourage subscriptions and usage;
- how to ensure that prices recover overall average costs, while also preserving the opportunity to offer below-cost discounts as a marketing tool;
- how to grow the subscriber base by responding to different customer needs, e.g., high volume customers, low-volume or personal safety use customers, business accounts, lower income customers;

- how to encourage both inbound and outbound callers to use their networks and not the network of a competitor;
- how to manage traffic flows, so as to prevent "call-back" and arbitrage incentives that distort calling patterns.

<p>DATA DEMONSTRATES THAT THE EUROPEAN MARKET IS COMPETITIVE</p>
--

European retail data presented hereafter demonstrates that:

- the price of using mobile telecommunications has decreased sharply in the recent past;
- the overall number of subscribers have shown a consistent pattern of increase;
- the number of optional consumer price plans has increased;
- a number of other developments reflective of competition have occurred in the mobile market.

This data provides conclusive evidence that the European mobile market is at present highly competitive and is already working to the benefit of consumers. The data is also wholly inconsistent with data derived from markets characterized by the abuse of market power. None of the hallmarks of anticompetitive industries are present in the mobile market - whether that be measured in terms of declining usage, decreased innovation, limits on production, deteriorating quality, or a lack of price competition.

## THE OVERALL NUMBER OF SUBSCRIBERS HAS INCREASED

Chart II, entitled "Western European Cellular Subscribers - a 523% increase over 5 years," shows that the number of mobile subscribers has increased from under 6 million to nearly 40 million in the last 5 years.

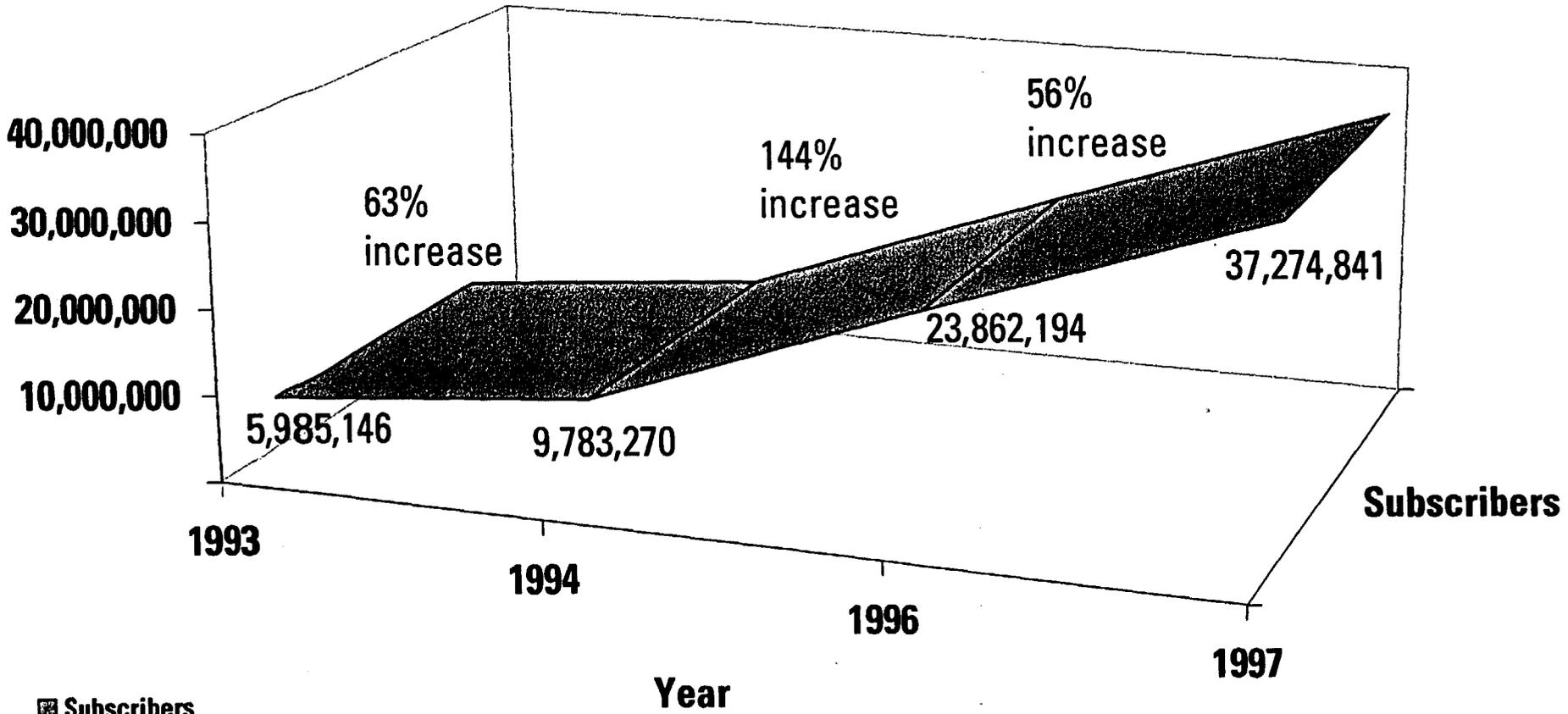
Chart III, entitled "Number of European Subscribers: Past, Current, Projected," shows that, while subscriptions have increased across all market segments, the most rapid growth has been - and will continue to be - in the number of consumers using mobile for their personal use. The introduction of pre-paid services will also fuel growth of the market. These trends are indicia of competitive pressures forcing mobile operators to reach out to new market segments. These new market segments mean, once mobile services have fully penetrated the professional user market segments, that their natural migration is towards the mass market. Price competitiveness is the hallmark of any such market extension. The downward pressure on prices is driven by the fact that economies of scale result in the more cost-efficient use of the mobile operator's network and by the fact that domestic consumers are more price sensitive. Moreover, the high levels of churn and the refiling of mobile terminated traffic which currently characterise the industry also suggest that the original niche target markets - professional users - are also becoming increasingly more price sensitive.

The increase in subscribers means that mobile operators are investing in new network capacity, and must continue to invest in new capacity. Such investment is a primary indicator of a competitive market.

The increase in subscribers also means that new operators are entering the market. Ellman McCartney Media's study of European Cellular Tariffs for 1994 covered 20 countries with 33 operators running 45 networks. In 1997, the same study reviewed 39 European operators and 69 networks in the same 20 countries.

# Western European Cellular Subscribers A 523% Increase Over 5 Years

CHART II



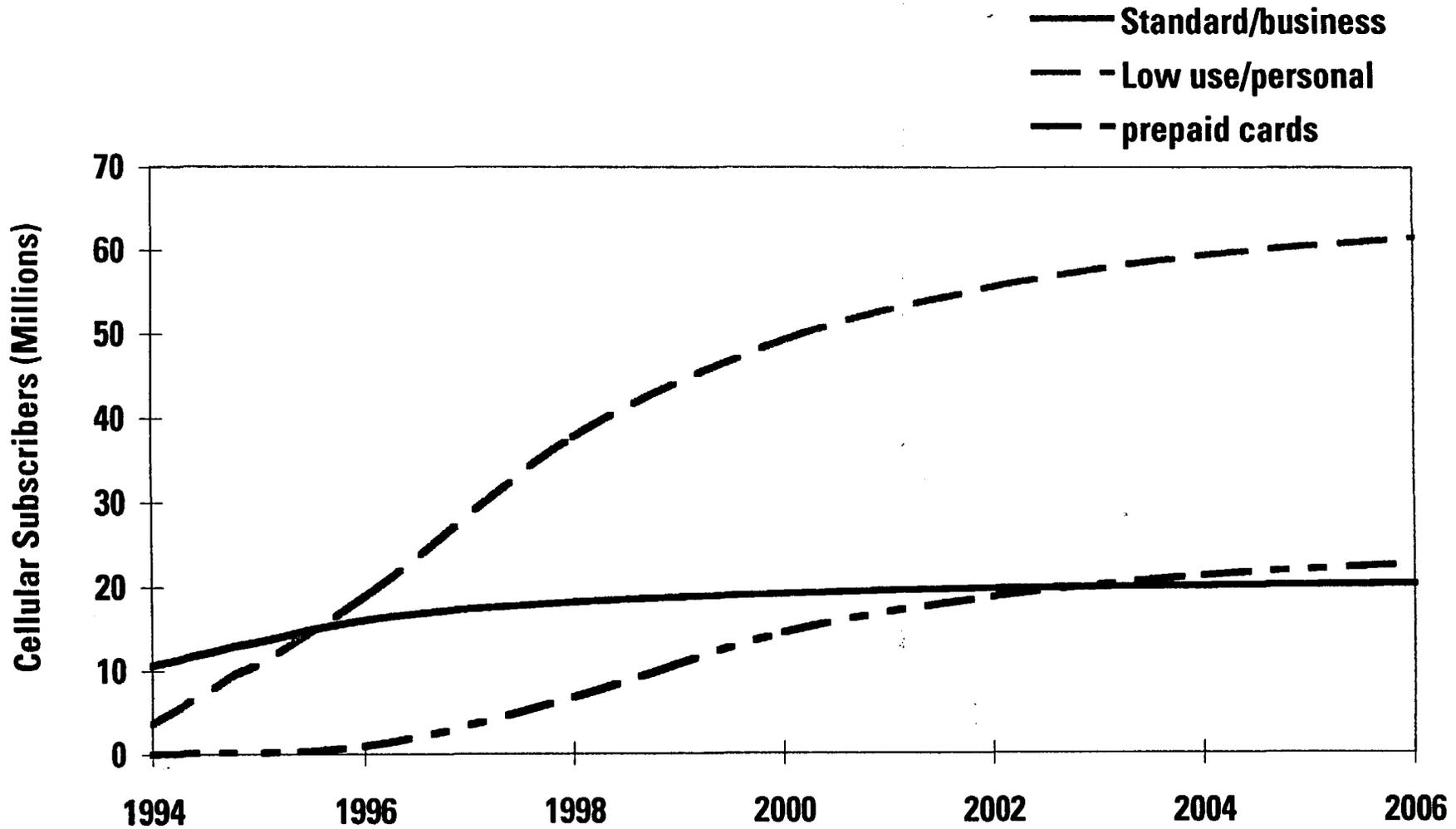
■ Subscribers

Source: Elman McCartney Media

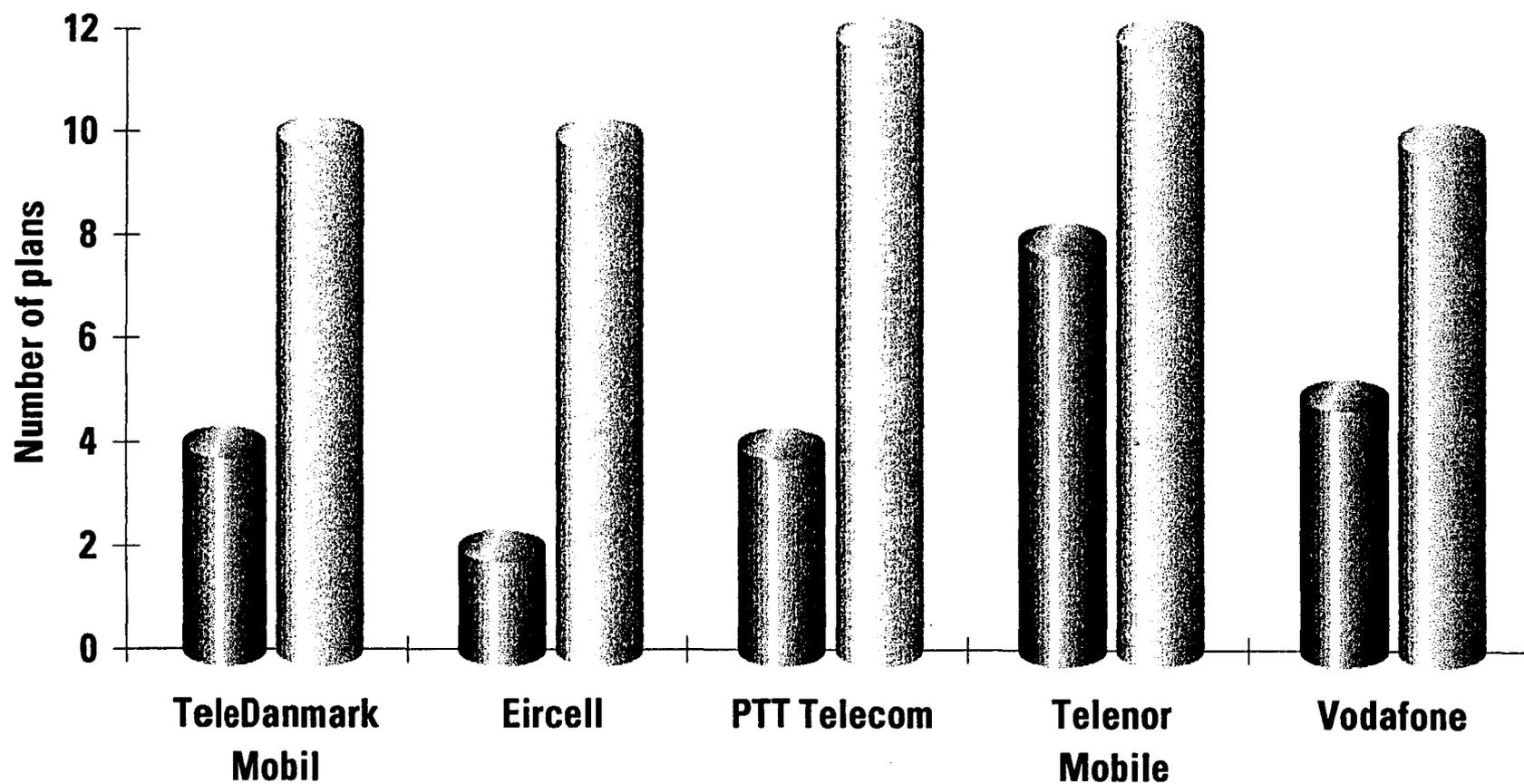


# Number of European Subscribers: Past, Current, Projected

CHART III



# Number of Customer Rate Plan Options

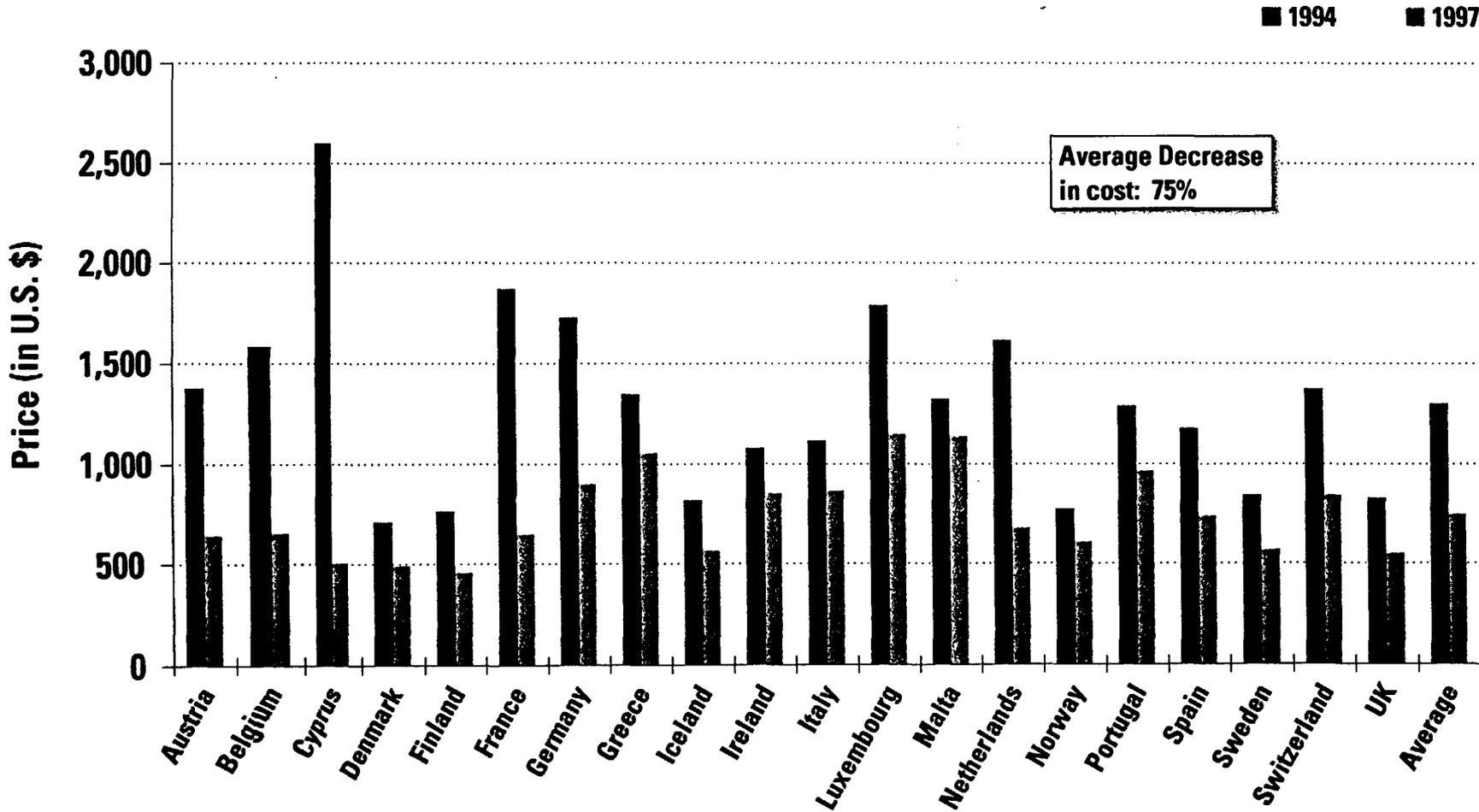


■ 1994

■ 1997

# Lowest 3 Year Cost\* of a Cell Phone Service for a High User

CHART VI



\*Includes:

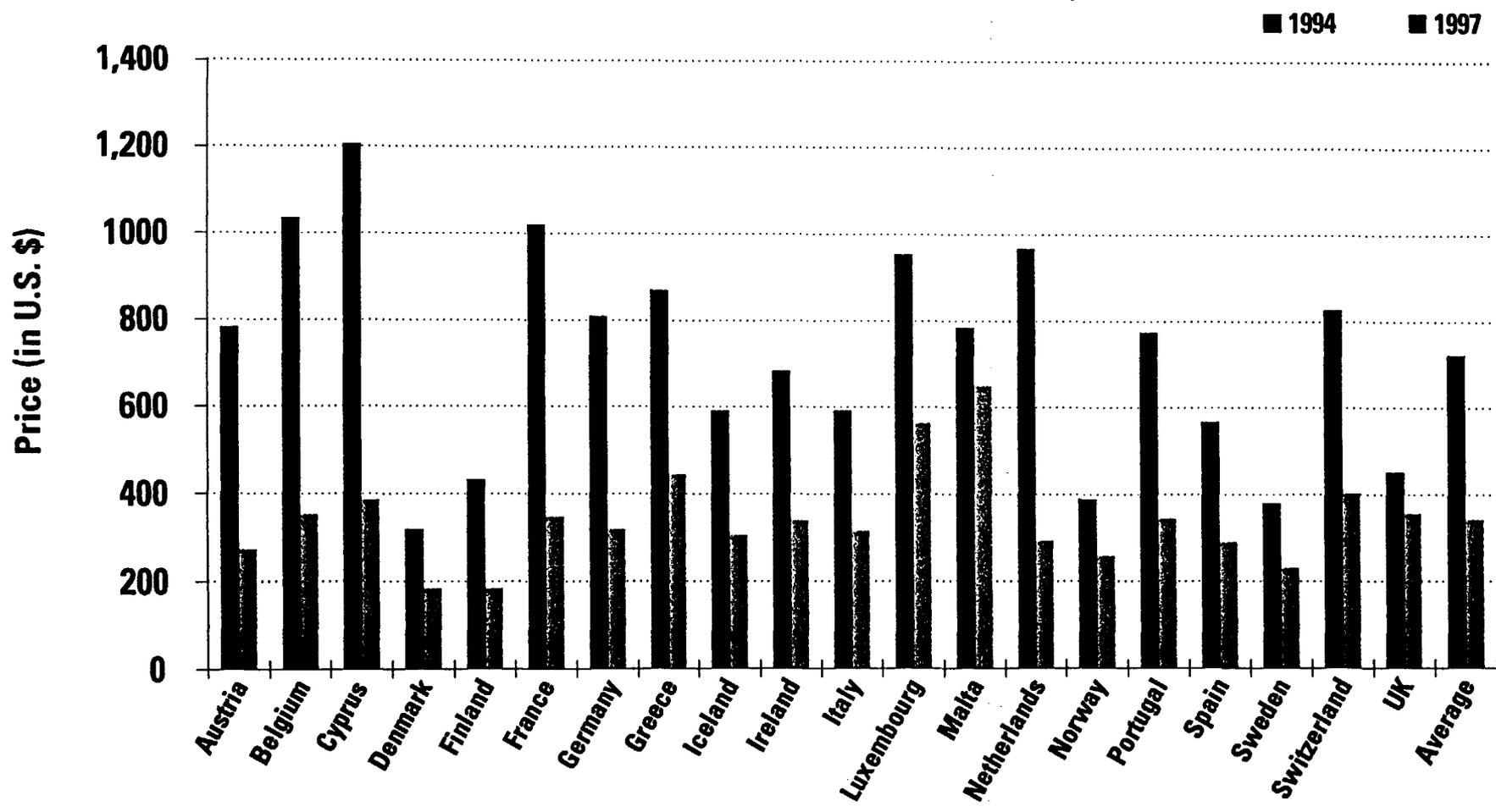
Cost of phone, Connection, monthly fee, 100 t peak, 200 min off-peak

Source: European Cellular Tariffs, Elmer McCartney Media, 1994-1997



# Lowest 3 Year Cost\* Of A Cell Phone Service For A Low User

CHART V



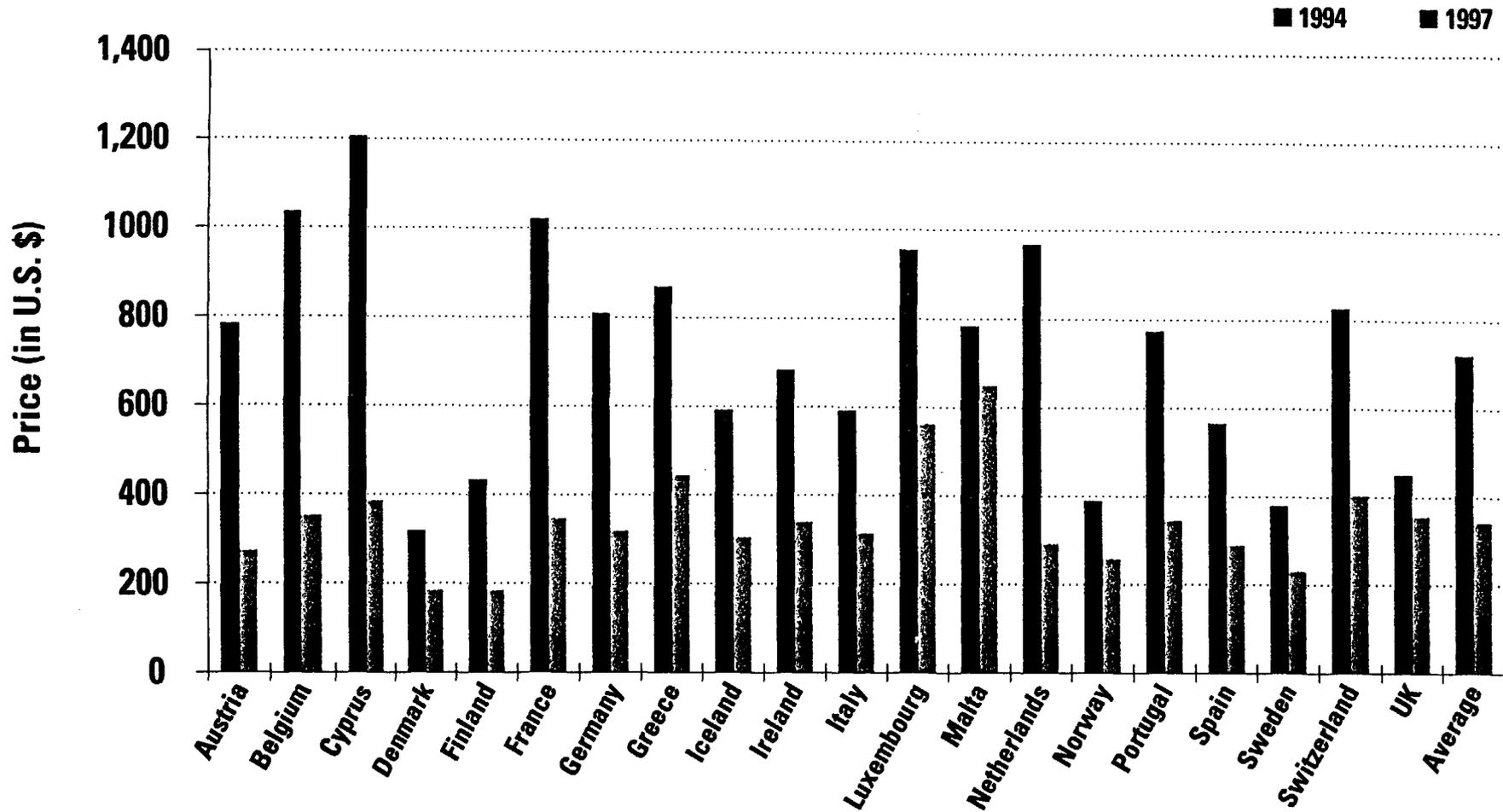
\*Includes:  
 Cost of phone, Connection, monthly fee, 10 min  
 talk, 30 min off-peak

Source: European Cellular Tariffs. Elman McCartney Media, 1994, 1997



# Lowest 3 Year Cost\* Of A Cell Phone Service For A Low User

CHART V



\*Includes:  
 Cost of phone, Connection, monthly fee, 10 min  
 peak, 30 min off-peak

Source: European Cellular Tariffs. Elman McCartney Media, 1994, 1997

## CALL COMPLETION ON MOBILE NETWORKS IS NOT A BOTTLENECK FACILITY

All "networks" have externalities. However, it would be fundamentally wrong to assume that the network externalities which characterise fixed networks are the same as those which characterise mobile networks. For example, in a fixed line environment, network externalities mean that termination to an incumbent's fixed line network is tantamount to a "bottleneck" or "essential facility". Consequently, termination at cost measured in terms of a LRIC formula appears to be a suitable regulatory response. In a mobile environment, such a regulatory response would be wholly inappropriate. Our conclusions are based on a variety of reasons:

(i) Market dynamics

Unlike the fixed line market, which is dominated by an incumbent with disproportional large market share, the mobile market is characterised by fierce competition between at least three or four operators (analogue, GSM, DCS-1800 and UMTS operators in the near future). Unlike a fixed line incumbent, individual mobile operators do not have market power. Consequently, they have no incentive to abuse their control of any notional "bottleneck". The lack of ubiquity of mobile networks means that the types of network externalities which they generate are unlikely to be translated into abusive behaviour. Moreover, because new competitors are being rapidly introduced into the mobile sector, any notional market power which might be attributed to such network externalities is being quickly eroded.

The high degree of churn which is being experienced in the mobile sector is evidence of the fact that consumers are ready, willing and able to 'walk with the feet' to change their mobile operators. By way of contrast, transaction costs are significantly more costly for consumers wishing to change their fixed line operator.

As indicated earlier, evidence from a number of Member States suggests that the market is actively addressing these issues.

(2) Network architecture and economics

The most fundamental difference between a fixed network and a mobile network for the purpose of determining the costs of call termination is the fact that the latter does not attribute any particular assets of the network to the exclusive use of any given subscriber. Put another way, mobile operators may be local access providers but they do not provide anything which is tantamount to a "local loop" on the fixed line. The routing of mobile calls follows a path which is therefore very different to calls terminating on a fixed network.

The fact that no particular asset, but rather the whole network, is dedicated to any given specific customer means that the costs of termination will also be totally different. Similarly, because mobile penetration rates are continuing to climb, the economies of scale for most mobile operators across Europe are likely to improve over time (again, by way of contrast, the incumbent fixed line operator has not only achieved full penetration but should have amortised most or all of its costs over its long period of monopoly service provision).

(2) Regulatory positions at EU level

Community law is explicit in two important respects, namely:

- (i) mobile operators are not subject to ONP rules; and

- (ii) call termination charges to mobiles are to be determined in light of the overall "market for interconnection".

In the absence of a finding of collusion under the competition rules, these Community legal standards are rendered meaningless if regulatory intervention proceeds on the basis that call termination to mobiles is tantamount to a "bottleneck".

Moreover, as has been repeatedly borne out by US market experience (refer to expert pleadings in *United States of America v. Western Electric Company, Inc.* of 29 July 1992, by Prof. Jerry Hausman of MIT - Appendix A), competition between even only a handful of mobile operators can have all of the hallmarks of a fully competitive market over a very short period of time, without the need for any regulatory intervention. Constructing "complex oligopoly" or "joint dominance" models for the mobile sector as the basis for regulatory intervention does not accord with market realities, as US practice has shown. Moreover, the increase in DCS-1800 licensees and, eventually, UMTS licensees, means that each and every significant geographic market will have a minimum of four licensees of mobile networks.

#### IV. CONCLUSION

Currently, the price of an inbound mobile call in Europe is affected substantially by the level of charges for interconnecting the fixed and mobile networks. In an optimal regulatory environment, however, the mobile operator would set the price of inbound and outbound calls as part of its overall strategic plan to respond to competition, and by doing so to attract both outbound and inbound network usage. Interconnection costs would be recovered separately, with a dominant fixed operator's interconnection rates required to be cost-oriented and non-discriminatory.

The European mobile market is competitive, as evidenced by numerous indicators of competition appended to this document, including falling prices, increased subscribership levels, innovation

and variety in price plans, promotions and discounts, and other marketing methods used to increase mobile usage.

Seen in this context, regulatory intervention whose net effect is to act as some form of price-setting mechanism threatens to distort the market signals on which the competitive resilience of the mobile sector is based. Shifting regulatory models from the fixed line environment to that of the mobile environment without qualification will almost certainly yield results which are at odds with market realities.

Accordingly, AirTouch would urge all regulators to exercise due caution in embarking upon steps of positive regulatory intervention without weighing all of the historical economic and commercial factors which characterise the mobile sector. US practice illustrates that regulation in mobile markets has not led to lower prices in these markets. On the contrary, economic studies indicate that retail mobile prices are consistently lower in those markets where pricing is determined by market forces rather than regulation (refer to Prof. Jerry Hausman, *supra* – Appendix A).

\* \* \* \* \*

AirTouch International  
June 1998

***ATTACHMENT 3***



COMISIÓN EUROPEA  
Servicio del Portavoz

EUROPA-KOMMISSIONEN  
Talsmandstjenesten

EUROPÄISCHE KOMMISSION  
Dienst des Sprechers

ΕΥΡΩΠΑΪΚΗ ΕΠΙΤΡΟΠΗ  
Υπηρεσία Εκπροσώπου Τύπου

EUROPEAN COMMISSION  
Spokesman's Service

COMMISSION EUROPÉENNE  
Service du Porte-Parole

COMMISSIONE EUROPEA  
Servizio del Portavoce

EUROPESE COMMISSIE  
Dienst van de Woordvoerder

COMISSÃO EUROPEIA  
Serviço do Porta-Voz

EUROOPAN KOMISSIO  
Tiedotuspäällikön yksikkö

EUROPEISKA KOMMISSIONEN  
Talsmannatjänsten

IP/98/707

Brussels, 27<sup>th</sup> July 1998

## Commission concentrates on nine cases of mobile telephony prices

*Following an inquiry into the high mobile communications prices in all Member States, the European Commission has concluded that at least fourteen cases warrant in-depth investigation given preliminary indications of possibly excessive or discriminatory prices. These conclusions are based on data provided by fixed and mobile operators in reply to formal requests for information earlier this year. The Commission will however stay its own proceedings in five cases in favour of action by the relevant national authorities. The fourteen cases comprise: 4 cases of mobile-to-fixed termination charges by Deutsche Telekom, Telefónica, KPN Telecom (Netherlands) and Telecom Italia respectively, which will be suspended for 6 months in favour of action by national regulators; 2 cases of termination fees charged by mobile operators in Italy and Germany respectively; 8 cases regarding the retention by on fixed-to-mobile calls by public switched telecommunication networks (PSTN) operators Belgacom, Telecom Éireann, BT, P&T Austria, Telefónica, KPN Telecom (Netherlands), Telecom Italia and Deutsche Telekom. The Commission will suspend the case involving BT given an on-going inquiry by the UK Monopolies and Mergers Commission (MMC) on this issue. The Commission will take into account recent or future price changes by the operators in the carrying forward of the investigation.*

In January, the Commission launched an inquiry into interconnection charges between fixed and mobile operators opening 15 cases, i.e. one for each Member State, due to growing concern about persistently high prices for mobile communications, particularly for fixed-to-mobile calls. In the UK, OfTel started a similar investigation in 1996 and referred the matter to the MMC at the beginning of 1998.

Interconnection charges agreed between operators for the termination of calls are crucial to prices for calls between fixed and mobile phones. The objective of the Commission's inquiry was to check whether:

- prices charged by the PSTN operator for terminating mobile calls into its fixed network are excessive or discriminatory;
- termination fees charged by mobile operators, which have joint control among themselves over call termination in their networks, are not excessive; and
- revenues retained by the PSTN operator on fixed-to-mobile calls are not excessive.

To gather the necessary data, the Commission sent requests for information to mobile and fixed operators of all Member States and, for each target area, devised tests to detect signs of excessive and/or discriminatory prices. These tests consisted of EU wide comparisons of a given operator's revenues on different types of services (e.g. call termination and call origination).

**PORTE-PAROLE**

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The preliminary conclusions of this analysis are only indicative and must be subject to further in-depth investigation. To narrow down the scope of the inquiry, the Commission has therefore identified the above 14 cases, where indications are strongest that further in-depth investigations are warranted. The Commission also notes that certain Member States are conducting investigations of their own into possibly excessive mobile termination charges and that it will follow the outcome of those enquiries.

## **Background**

Retail tariffs are not determined by one operator alone given that most calls involve two networks. Basically, the retail price for national mobile to fixed calls is the sum of two elements, i.e. the revenue kept by the mobile operator and the termination charge that the latter pays to the PSTN operator. The retail price for national fixed-to-mobile calls is also the sum of two elements, i.e. the revenue retained by the PSTN operator and the termination charge the latter pays to the mobile operator. The Commission's investigation focused on the latter three of these four elements wherever there was potential for abusive behaviour.

### **1. Termination of mobile-to-fixed calls**

Four PSTN operators charge mobile operators more, sometimes even significantly more than fixed operators for call termination: **Deutsche Telekom (Germany), Telefónica (Spain), KPN Telecom (Netherlands) and Telecom Italia (Italy)**. The ONP framework offers national regulators procedures to tackle this issue. Therefore, in accordance with the principles set out in its "Access Notice", the Commission will contact the NRA and suggest that they pursue the investigation in these cases. The Commission will then stay its proceedings for 6 months.

### **2. Mobile termination charges**

Various tests revealed anomalies in charging structures which indicated that these charges may generally be excessive. In most cases for instance, mobile operators' revenue from call termination is much higher than their revenue for origination of mobile-to-mobile calls. Similarly, termination rates are in many cases higher than the end-user price for own network calls (i.e. mobile-to-mobile calls within the same network). The Commission then 'benchmarked' peak mobile termination rates to identify the countries where charges were most likely to be excessive.

On this basis, and with an aim to narrowing the scope of the inquiry, a further in-depth investigation is called for in two Member States where peak termination rates are strongly in excess of the benchmark derived from the inquiry, namely among **mobile operators in Italy and Germany**. The Commission has also identified four other Member States, namely France, Sweden, the Netherlands and Portugal, whose mobile operators it might investigate further if necessary.

### **3. Fixed operators' retention**

Where the incumbent fixed network operator is also active on the mobile market, this operator could offset reductions in mobile termination rates by increasing its retention on fixed-to-mobile calls. Therefore, the issue of mobile termination cannot be

considered without simultaneously looking at the PSTN operators' retention for fixed-to-mobile calls. In 8 cases, this retention appears to be largely in excess of a best practice established by the Commission for this inquiry, which might indicate excessive profits: Belgacom, Telecom Éireann, BT, P&T Austria, Telefónica, KPN Telecom (Netherlands), Telecom Italia and Deutsche Telekom

Stefan RATING: 299 40 09  
Lone Mikkelsen: 296 05 67

## **ATTACHMENT 4**



*JSE 2096*

*Great Lakes*

### DETAILED CHARGES

For orders or customer service needs, call 1 800 480-8088  
For billing inquiries or payment arrangements, call 1 800 789-7899  
Office hours are 8:00am-6:00pm Monday thru Friday  
For repair service, call 221-3000

810 358-7600.8  
Dec 07, 1996

#### Itemized Calls - continued

NO.	DATE	TIME	PLACE CALLED	NUMBER	CODE	MIN
-----	------	------	--------------	--------	------	-----

Total AVCP usage for 358-7600 22 hours 9 min

#Charge included only in Ameritech Value Calling Plan Summary

#### Calls Charged to 358-7608

##### Zone Calls

1	11-11	142P	WARREN	MI 810 795-0068	D1	1
2	11-26	1050A	WARREN	MI 810 977-1477	D1	1

Total calls charged to 358-7608 .....

#### Calls Charged to 358-7609

##### Itemized Calls

#### CALLS TO AIRTOUCH CELLULAR NETW

9	11-25	555P	MOBILE USE	CH 810 246-9427	U1	1
			Fr SOUTHFIELD	MI 810 358-7609		
4	11-25	557P	MOBILE USE	CH 810 246-9427	U1	5
			Fr SOUTHFIELD	MI 810 358-7609		
5	11-25	602P	MOBILE USE	CH 810 291-2281	U1	3
			Fr SOUTHFIELD	MI 810 358-7609		
6	11-25	605P	MOBILE USE	CH 810 291-2281	U1	1
			Fr SOUTHFIELD	MI 810 358-7609		
7	11-25	606P	MOBILE USE	CH 810 292-2947	U1	1
			Fr SOUTHFIELD	MI 810 358-7609		
8	11-25	608P	MOBILE USE	CH 810 292-2947	U1	1
			Fr SOUTHFIELD	MI 810 358-7609		
9	11-25	609P	MOBILE USE	CH 810 292-2947	U1	1
			Fr SOUTHFIELD	MI 810 358-7609		
10	11-25	612P	MOBILE USE	CH 810 291-2281	U1	2
			Fr SOUTHFIELD	MI 810 358-7609		
11	11-25	614P	MOBILE USE	CH 810 246-9427	U1	3
			Fr SOUTHFIELD	MI 810 358-7609		
12	11-25	617P	MOBILE USE	CH 810 292-2947	U1	3
			Fr SOUTHFIELD	MI 810 358-7609		
13	11-26	1246P	MOBILE USE	CH 810 246-9427	U1	1
			Fr SOUTHFIELD	MI 810 358-7609		

*terminal usage*

FOR CALLING CODES PLEASE SEE THE BACK OF THE FIRST PAGE