

## **Comments on the Draft COMMISSION RECOMMENDATION on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU**

### ***I. General Comments***

Arcor AG & Co. KG (Arcor) wishes to thank the Commission of the EU for the careful and considered analysis of wholesale call termination rates.

We agree that the problems of cost-modelling and NGN-based services are of utmost importance for today's and the future regulatory framework. We agree especially with ERG that the questions of symmetries / asymmetries constitute an important module of today's and the future regulatory framework.

It is in the nature of European consultation process, that the problems and suggested regulatory solutions are presently rather abstract. Subsequently, we therefore wish to substantiate the problems operators are facing in the German context in particular, and wish to suggest regulatory measures which from our point of view will be effective in ensuring sustained competition. We strongly believe that our analysis are also valid in the wider European context.

Arcor as a fixed operator only comments on fixed termination rates (FTR) and not on mobile termination rates (MTR).

### ***II. Symmetry of termination rates for identical services***

Arcor agrees with the opinion of the ERG and the EU-Commission that any divergence from symmetry requires a good justification. This is especially true when asymmetries have been introduced well after the beginning of liberalization, e.g. like in Germany in 2004. From 1998 to 2004 the market has constantly moved towards competition without the assistance of asymmetric FTR.

Asymmetries in FTR can be justified by different cost structures. Different cost structures can emerge because:

1. "Wholesale termination" can consist of different services. Especially in an "All-IP-world" different quality of (termination) services might appear. Quality of service (QoS) in telephony is at its peak with TDM-technology. Until now VoIP is a decrease in QoS because quality is not built in the service definition and the user of a broadband network

without QoS management has barely any means to influence QoS when it is too low. Therefore a substitution of TDM- and IP-based telephony is only possible, if the latter guarantees the same QoS as TDM-technology. We would call this IP-technology “Voice of over NGN (VoNGN)”.

Beside that IP-based telephony the best effort product “Voice of over Internet (VoInt)”, which is routed completely or partially through the public internet without guaranteed QoS, is also expected to exist further on. Different qualities account for different costs and therefore can justify different termination rates. Moreover, the efficiency of telecommunications networks can vary because of differences in business models and quantities of sales. NRA should take such differences into account and consider if they justify a spread in termination rates.

2. Economies of scale: Termination services is not a component of access but of the wide area network (backhaul and backbone). Arcor does not expect economies of scale in the backbone part of termination services, because backbone-traffic is scalable in reasonable increments for additional traffic. This is possible because different services (voice, data, IPTV) add up to a large amount of traffic, so that an increment is a relatively small fraction of overall traffic.

In the backhole part economies of scale can be detected, especially in rural areas. A main reason for economies of scale are different numbers of subscribers. Fixed costs of the backhole network have to be divided by the number of subscriber to get average costs per customer. In rural areas the number of subscribers might be so low, that an additional increment can not be used fully and comprises unused capacity. This leads to higher average costs and constitutes a reason for asymmetric termination rates.

3. Differences in coverage: It is more expensive to invest in a backhaul-network in rural areas compared to urban areas. In absolute values the higher costs arise from longer distances in rural areas. Cost differences in absolute values are amplified by economies of scale. The already higher investments in the network have to be divided by the relatively low number of subscribers in rural areas, which leads to even higher average costs.

For reasons of practicability different cost structures should not lead to a variety of asymmetric termination rates. It would not be realistic to calculate and implement individual termination rates for each carrier. Information- and transaction costs would exceed any possible advantage of such a regime.

With further differentiated rates “second- and third follower” would be rewarded for their risk-averse investment behaviour, since they typically have less customers and higher average costs than “first mover” and “first follower”. Therefore only costs of the “first follower” should determine a possible, homogenous mark-up on incumbents’ wholesale termination rates.

### ***III. Cost model***

A cost model has to incorporate the hybrid-migration-path from PSTN- to NGN-technology and to analyse what this hybridism means for termination charges. There will be a time period, where both technologies will be used simultaneously, with an increasing amount of IP-termination and a decreasing amount of PSTN-termination. A 100%-migration at a certain point of time would not be cost efficient.

Regarding the related termination rates it is to point out that in general costs of NGN will be lower than costs of PSTN. The focus of cost-savings will be on operational cost (OPEX). It is to mention that operating costs of both networks, PSTN and NGN, have to be allowed during the phase of simultaneous usage. These aspects limit the range for reduced termination rates.

A gliding-path from PSTN to NGN with gradually reduced termination rates will be the result of these considerations. The time period of such a gliding-path cannot be determined in advance, since it depends on the market development and dynamic factors. Therefore the length of time for full migration should be left to market participants and not be determined by regulatory authorities.

### ***IV. Common costs***

Arcor is of the opinion that it would lead to inconsistencies in rates, if common costs (here: “non-traffic-related costs”) which do not increase in response to an increase in wholesale termination traffic, are not allowed in determining regulated rates. These costs have also to be covered with other revenues of the regulated operator. If common costs are only allocated to unregulated services, these services would be systematically more expensive than regulated services. The regulated operator would have an incentive to allocate costs especially to unregulated services that are not substitutable by regulated services. The result would be a distortion towards unregulated but necessary services.

If common costs can not be allocated to wholesale services, operators would be forced to raise retail prices to regain common costs. Since all operators with regulated termination rates would

face the same problem, they would have the possibility to adjust retail prices even in competitive markets. Such a substantial mark-up in the whole market would contradict the aim of consumer-protection. Additionally, it would not be possible to reduce common costs in a short-term.

It is also not an option to ignore common costs completely. If markets are competitive and prices near variable costs, as it is aimed by the commission, there is no economic space to generate revenues for covering common costs at all. If common costs would not be included in any price, operators would always have higher expenditures than revenues and go, by definition, bankrupt.

Therefore common costs should be allocated proportionally to all services, including wholesale products. The precondition is that specific common costs are necessary and related services are provided efficiently. Such an allocation would avoid distortions and reflect the regulatory practice in Germany and probably most countries of the EU.