

Response by BT to

EC Draft Recommendation

on

the Regulatory Treatment of
Fixed and Mobile
Termination Rates in the EU

10 September 2008

Comments on this Response are welcome and should be addressed to:
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SUMMARY

BT fully endorses the Commission's recognition that across the European Union, mobile termination rates have been set at levels that far exceed the incremental cost of terminating calls. As the Commission notes, this is distorting competition between fixed and mobile operators and, above all, penalising ordinary fixed phone users who have to all intents and purposes been taxed to subsidise the mobile phone companies.

BT particularly welcomes the Commission's insight that a key difference between fixed and mobile termination rates is that fixed termination rates have been set to recover just the incremental costs of carrying a call to the called party but mobile termination rates also recover some of the basic costs of providing mobile phone users with *access* to the mobile phone network (such as the cost of spectrum licences, the basic costs of laying out the network to provide signal coverage and even, in some countries, a share of sales and marketing costs and handset subsidies). Fixed customers pay all the fixed access costs through line charges, so BT strongly supports the Commission's view that they ought not to be required to pay towards mobile *access* costs through high charges to call mobile phones.

BT's prime concern with the Recommendation concerns the implementation timetable. As the draft Recommendation now stands it could be applied to fixed termination rates before it is applied to mobile termination rates. This would lead to the perverse outcome that competitive distortions would be increased for a period. BT therefore strongly believes that the Recommendation must require NRAs to review fixed and mobile termination rates at the same time or, failing this, to first address mobile termination rates since these will be the ones most out of line with cost and so most penalising customers and distorting competition. BT therefore suggests the Recommendation be modified to include words such as these:

NRAs should seek to harmonise their approach to fixed and mobile call termination services by implementing this Recommendation simultaneously for fixed and mobile operators or, failing this, by ensuring that mobile termination rates are addressed before fixed termination rates.

Finally, BT agrees with the Commission that termination rates should normally be symmetric and that there is no case for asymmetric rates in markets that are fully open to competition. This said, BT believes that offering higher rates to market entrants for a limited period remains a useful policy tool for NRAs in markets where entrants still face significant barriers to entry and expansion.

BT's Specific Comments on the Recommendations listed on page 7 to 8 of the Draft Recommendation.

(1) NRAs should set symmetric termination rates based on the costs incurred by an efficient operator.

BT agrees with the use of an efficient operator cost standard with one qualification. In desk-based assessments of the costs of such an operator, NRAs ought not to suppose standards of efficiency and foresight that would be impossible to achieve in practice. For example, efficient operators need to install capacity before it is utilised (pre-provisioning) and, as noted in the Explanatory Note (Section 4.1), Bottom-up (BU) models may understate the costs where technologies are rapidly changing and operators cannot instantaneously change their technologies.

(2) The evaluation of efficient costs is based on current cost and the use of a bottom-up modelling approach using long-run incremental costs (LRIC).

BT agrees with the use of LRIC and current costs.

The use of BU modelling techniques may also be justified, but BT believes that, where they exist, the Top Down models which underpin regulatory accounts ought to be able to provide a robust view of termination costs. As noted above, theoretical BU models may exclude costs which have been efficiently incurred, and it must also be appreciated that the concept of a communications network which does not provide termination is a theoretical construction. This compounds the risk that BU modelling may diverge from reality. BT therefore believes that the emphasis should be on the use of robust distributed cost systems in all Member States (and that these should be created where they do not exist). Only where, exceptionally, these do not exist then BU modelling might be used instead.

(3) The cost model should be based on efficient technologies available in the timeframe considered by the model.

BT agrees on the use of efficient technologies with one qualification. In the cost models that it uses, NRAs ought not to disregard costs which are necessarily incurred in the transition from one technology to another. This would reflect the fact that many network assets are not re-useable with new technologies, with the result that migration costs would be incurred by any efficient operator which is seeking to minimise its long run costs by incurring extra costs in the short term. Such migration costs should therefore be recognised in call termination rates.

(4) Definitions of common cost and incremental costs

BT has no comments.

(5) Within the LRIC model, the relevant increment should be defined as the wholesale voice call termination service provided to third parties.

BT agrees with this recommendation but calls on the Commission and NRAs to recognise that (i) reducing the proportion of common costs recovered through

termination rates means that other prices, including some regulated prices will have to rise (ii) that administrative and other fixed costs have to be incurred to support wholesale activities, such as the provision of call termination.

BT does not consider that the relevant increment should be defined as the “off-net” wholesale voice call termination service (ie only services provided to third parties). The cost of service provided to third parties should be no different to that involved in internal provision to the supplier’s own downstream business. Any assessment of pricing behaviour of fixed or mobile operators should also use an imputed cost for call termination which is the same as that charged externally. The same unit cost should therefore apply to call termination whether provided for internal purposes or provided to third parties. The relevant increment should therefore be defined as wholesale voice call termination service provided both internally and to third parties.

BT agrees that a distinction needs to be made between traffic-related costs and non traffic-related costs, and that the latter costs should be disregarded for the purpose of calculating wholesale termination rates. Fixed customers pay the cost of access coverage of fixed networks and the same should be true for mobile customers. Certainly, fixed customers should not pay a subsidy towards the access / non-traffic related costs of the mobile operators.

The suggestion in the last paragraph of Section 5.1.2 of the Explanatory Note, regarding the method of estimating avoidable costs, seems unduly complex and calculations of this type which derive an estimate as a residual are not usually reliable. Where BU cost modelling is used, we suggest that a simpler and more direct approach is adopted.

(6) The recommended approach for asset depreciation is economic depreciation wherever feasible.

BT requests that the Commission provides more information as to its definition of this term and explains the practical difference in using economic depreciation rather than the alternatives. Economic depreciation is not, for example, discussed in the Explanatory Note accompanying the Draft Recommendation. Without a standardised approach to this term, which may be interpreted by NRAs in a number of different ways, the Recommendation will not be likely to achieve harmonisation of approach across the EC.

(7) Principles for defining the appropriate efficient scale in fixed and mobile termination networks.

BT agrees that entrants in the fixed markets can benefit by operating in high density areas and sometimes make use of wholesale services provided under regulatory terms. However, where markets have not been free and fully open for a reasonable period of time, or there have been persistent inadequacies in the provision of wholesale services, then there can be a role for time-limited asymmetrical rates so that barriers to entry can be overcome.

(8) Any determination of efficient cost levels which deviates from the principles set out above should be justified by objective cost differences which are outside the control of the operators concerned.

BT agrees that such deviations should have objective justifications which are outside the control of the operators concerned. This will require careful scrutiny by NRAs.

(9) NRAs may compare the results of the bottom-up modelling approach with those of a top-down model which uses audited data with a view to verifying and improving the robustness of the results.

BT agrees that such a comparison may be informative in improving the robustness of the results, but believes that a robust distributed cost model can be the principal basis for effective price regulation. The Recommendation should avoid imposing on operators an excessive burden in terms of requiring them to populate two different cost models, and requiring these two different models to be reconciled.

(10), NRAs should ensure that termination rates are applied at a cost-efficient, symmetric level by 31.12.2011. Asymmetries that are currently applied should be phased out by that date, subject to any objective cost differences identified in accordance with point 8.

BT agrees that such a timetable is reasonable. We have commented in the Summary Section of this Response on the need to ensure that the Recommendation is not applied to fixed networks before it is applied to mobile networks. This is to avoid the Commission introducing a Recommendation which actually increases the distortion of competition between fixed and mobile operators whilst aiming to remove it. BT therefore strongly believes that the Recommendation must require NRAs to review fixed and mobile termination rates at the same time or, failing this, to first address mobile termination rates since these will be the ones most out of line with cost and so most penalising customers and distorting competition. BT therefore suggests the Recommendation be modified to include words such as these:

NRAs should seek to harmonise their approach to fixed and mobile call termination services by implementing this Recommendation simultaneously for fixed and mobile operators or, failing this, by ensuring that mobile termination rates are addressed before fixed termination rates.

(11) An NRA could consider setting interim prices based on an alternative approach until 31.12.2013. Such an outcome should not exceed the average of the termination rates set by NRAs implementing the recommended cost methodology.

BT agrees that this extension is reasonable subject to the condition set out by the Commission.