

**ECTA response to public consultation by the Commission on
Draft Commission Recommendation on the Regulatory Treatment of Fixed and
Mobile Termination Rates in the EU¹**
September 2008

Executive Summary

- ECTA largely supports the methodology and accounting principles proposed by the Commission for the regulation of wholesale termination rates
- There is ample evidence that in particular the wholesale MTRs of incumbent mobile operators are in excess of their actual costs, which makes calls more expensive for consumers and severely distorts competition
- From a competitive perspective, even more than the absolute cost levels for MTRs, the most pressing issue is the on-net/off-net discrimination practice of incumbent mobile operators that creates and reinforces the ‘club-effect’ and undermines competitive conditions for fixed operators and later mobile entrants. ECTA, welcomes lower MTRs as a way of eventually addressing this issue, but suggests that in the short term this seriously distortive behaviour should be addressed by the strict enforcement of non-discrimination by NRAs.
- ECTA does not believe that an obligation for absolute symmetry is compatible with the principle of effective cost orientation. Effective cost orientation is the right tool in order to avoid competitive distortions and ensure that all operators in the market have incentives to make efficient investments. The imposition of symmetry by levelling all operators to the cost structure of the dominant operators is likely to result in distorting competition preventing cost recovery by alternative and non dominant operators, while incumbent operators and early entrant mobile operators would be the only ones able to recover their costs.
- There are objective cost differences for fixed new entrants beyond their control that should be taken into account by the Recommendation as exogenous factors in a similar way to uneven spectrum assignments for mobile networks. For example the number of points of interconnection are determined by the incumbents’ PSTN architecture and are most likely result in a network structure

¹ The views expressed in this position represent the views of fixed entrants and late entrants to the mobile market but cannot be assumed to represent the views of ECTA members with interests other than these, such as incumbent interests and early mobile entrant interests.

that is not the most effective one from the new entrants' perspective. Fixed networks are also less scalable to actual traffic volumes than mobile networks, whilst the traffic volumes for entrants may be restricted compared with incumbents due to higher customer acquisition costs and other barriers (including regulatory barriers) to expansion.

- The US mobile market is a good example of what impact low wholesale termination rates (in particular low wholesale mobile termination rates) have on retail offers. In the US consumers can choose from a wide range of cheap bucket plans addressing also the needs of low income users (shared buckets for example), with very low prices for additional minutes and nationwide usage. Received minutes are included in the bucket plans and therefore paying for received calls is not perceived by consumers.

Mobile termination rates

Excessive pricing

The cost of a call is composed of the cost for origination, termination and any transit in between. In theory this cost should be roughly the same whether carried on one operator's network end to end or over two or more interconnected networks. Under the currently prevailing wholesale charging regime in the EU, however, there are strong incentives for a terminating network to keep its wholesale termination charges high absent consistent regulation.

As the Commission pointed out in the Staff Working Document associated with the Draft Recommendation, one of the general competition problems in wholesale termination markets is *excessive pricing*, which is indeed the source of several specific problems distorting competition to the detriment of individual and professional users of mobile communications services.

In particular the wholesale charges levied by some European mobile network operators have been demonstrably in excess of the 'costs' that they have nominally charged themselves when calculating their 'on-net' retail prices, and also exceed wholesale termination charges levied in other areas of the world both in absolute terms (particularly when compared with countries using the Bill&Keep + RPP system such as the US) and in comparison with wholesale fixed termination rates (FTRs) in the EU.

The high absolute level of mobile termination rates (MTRs) in the EU is evidenced by several factors.

Currently MTRs are on average € 0.0967 per minute², which is approximately 9 times higher than average FTRs. While objective cost differences might exist between mobile and fixed termination, it is hardly comprehensible that these differences are of such a scale. ECTA suspects that this large difference is caused by the historically different regulatory treatment of MTRs, such as the recovery of the access networks' cost, which is assumed to be recovered through retail charges in fixed regulatory models and via wholesale MTRs in mobile networks as the Commission Staff Working Paper points out.

There are large differences between mobile operators' retail on-net and off-net pricing, which indicates that mobile operators' genuine costs are less than their actual wholesale termination fee.

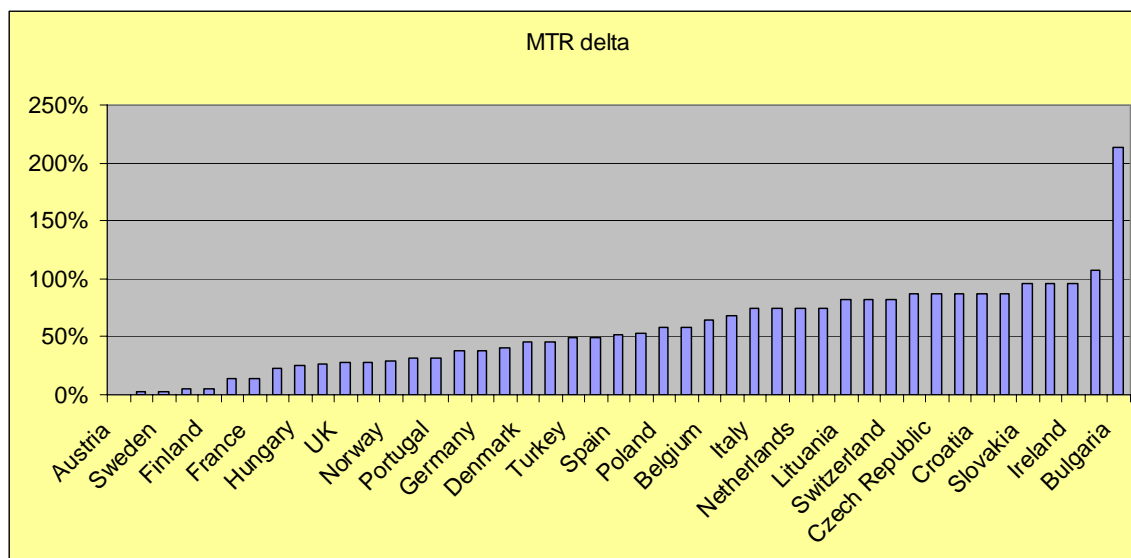
MTRs are significantly lower in other parts of the world, for instance in the US, Singapore and Canada, but also in Cyprus at € 0.02 per minute. In turn, service-based revenue per minute of use (average price) in Europe is consistently 50% - 400% higher than in the US, Singapore and Canada, which is largely attributable to wholesale termination rates according to WIK Consult.³

² 13th Implementation Report

³ WIK Consult, 'The Future of IP Interconnection: Technical, Economic, and Public Policy Aspects', 2008, p. 103 (WIK relies on Merrill-Lynch data)

Moreover, the service-based revenue per MoU (involving all calls, both on-net and off-net) in the US was about €0.03 per minute (4Q2006), which is likely to indicate that the cost of mobile termination is far lower than €0.03 per minute.⁴

There is also a huge variation of MTRs for relatively similar mobile networks across the EU not justified by objective differences in cost drivers. National specificities could explain a reasonable variation of cost levels (presumably around 15-20%), but in a large number of Member States the divergence of the MTRs of incumbent mobile operators (number 1 and 2) that should have similar cost levels is between 50% and 100% (even disregarding the exceptionally low MTR level in Cyprus).



MTRs of incumbent (number 1 and 2) mobile operators, April 2008

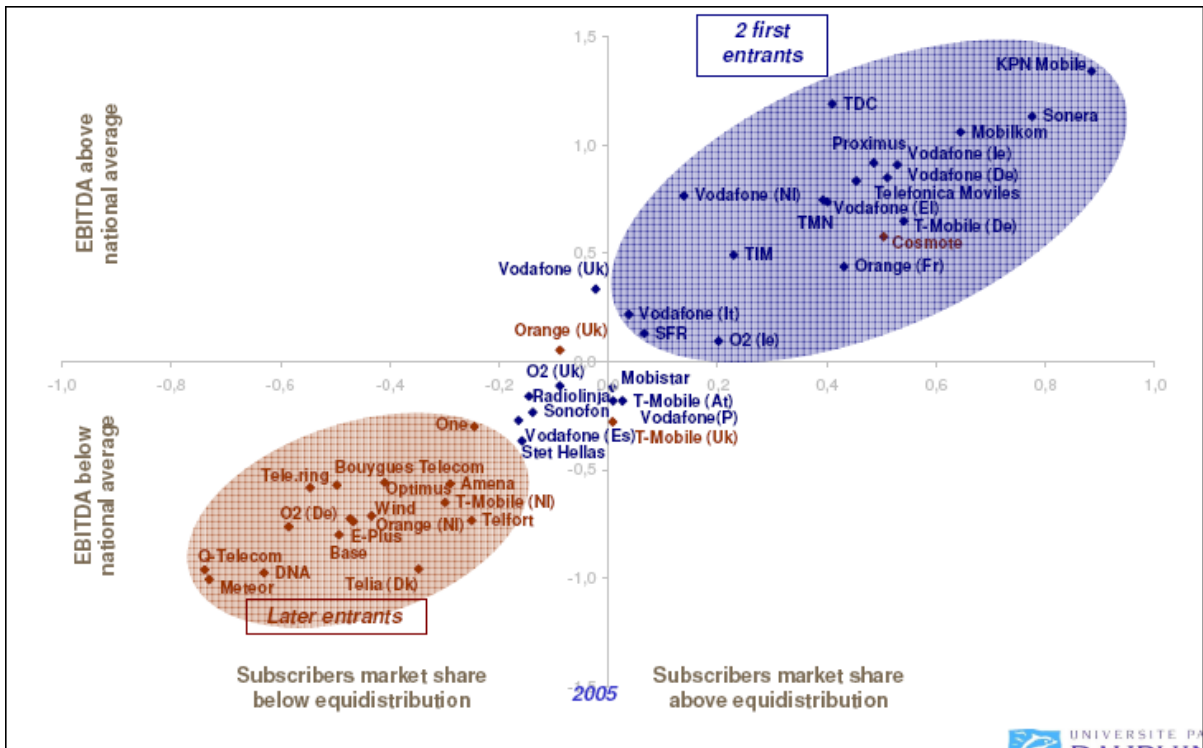
In addition, there have been examples of cost models producing significantly lower cost based MTRs than the current EU average.

ARCEP calculated average mobile termination costs for 2005 around €0.03 and €0.04 per minute and below €0.025 in 2010 and a WIK study found average incremental cost in Australia (a very large low density country) to be between €0.03 and €0.04 per minute.⁵

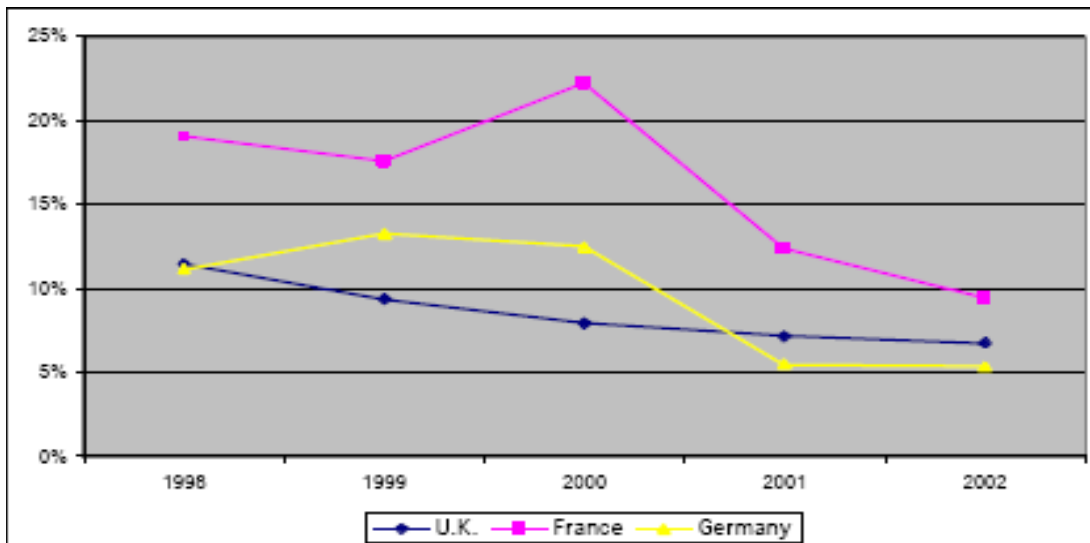
The Commission's Staff Working Document states that excessive pricing implies that operators may extract excessive profits at the wholesale level. Studies have shown that first and second entrant mobile operators (which typically includes the mobile arm of the fixed incumbent), which typically charge in excess of their costs at the wholesale level are much more profitable than new entrant mobile operators. In addition, wholesale termination rates often constitute a large proportion of the revenues of first and second entrant mobile operators. By comparison, both fixed and mobile entrants in most cases have a net outflow in termination payments to large mobile networks.

⁴ Ibid.

⁵ Ibid., at p. 104



Market share & profitability of late mobile entrants (Prof. Patrice Geoffron)



Transfers as a fraction of total mobile revenues (retail plus interconnection)⁶

⁶ CERNA, Warwick University and WIK Consult, 'How mobile termination charges shape the dynamics of the telecom sector', 2003, p. 52

In summary the ordinary customers of fixed networks pay for excessive mobile termination rate charges through excessive retail prices. Customers mainly reliant on fixed services – which include many businesses – would enjoy few or none of the benefits (even if they exist) that large mobiles suggest are associated with high MTRs. Moreover, if mobile retail markets are not themselves sufficiently competitive or if there is significant inertia preventing customers from switching from large mobile operators, high MTRs are likely to translate into higher profits for those operators rather than lower charges for consumers. The absolute level of MTRs is likely therefore to have a direct and detrimental effect on many customers.

Whilst we note that the EC also believes that some further adjustments might be necessary to fixed termination rates. Given the vast difference between fixed and mobile termination rates across Europe it would be perverse if the EC were to say force a reduction in fixed termination rates in advance of significant reductions in mobile termination rates. We would like to see an EC commitment to principles of timing and fairness in this regard.

On-net/ off-net discrimination

On-net/off-net retail pricing has a substantial impact on fixed/mobile competition and convergence as well as impacts within the mobile sector

Over and above the problem of excessive pricing, MTRs in excess of costs have resulted in on-net/off-net retail price differentiation whereby mobile operators charge themselves no or lower MTRs than the regulated MTR they charge to their competitors and offering cheap or free on-net calls but more expensive off-net calls to their retail customers.

On-net/off-net pricing behaviours, when practiced by mobile operators with high market shares, have significant detrimental effects not just on competition between mobile operators, but also on fixed/mobile competition and on individual and professional users of mobile communications services.

Fixed operators are placed at a disadvantage and/or excluded from particular markets as follows:

- High wholesale mobile termination rates effectively result in a substantial transfer between the fixed and mobile sectors affecting operators' ability to invest going forward.

ECTA agrees with the Commission's observation in the Staff Working Paper that the main advantage of low, cost based termination rates is that they minimise potential competitive distortions..

There have been some estimates made of the scale of fixed to mobile sector transfers. For example, WIK estimates the financial transfers from fixed to mobile networks in Germany to have been about ten billion euros for the

period 1998-2006.⁷ A CERNA-Warwick-WIK study found that the fixed to mobile transfer has been 19 billion euros in the UK, Germany and France between 1998-2002, and extrapolated that to over EUR 38 billion in the EU15 during the same period.⁸

According to the most recent TeleGeography report, mobile originated traffic has grown on average across whole of Europe by 5% every year from 2003 to 2006.

We think that the growth in traffic has generally compensated some of the reductions of MTRs introduced across the EU by most NRAs. For this reason we think that it would be fair to assume, on a conservative basis, that the transfer of revenues from fixed to mobile has remained stable across Europe in the following years to date. Taking as the basis the above studies and data, our estimate is that the transfer of revenues from fixed to mobile during the last 10 years across the whole of the 27 EU countries is in excess of 100 billion euros.

- Mobile operators are able to undercut fixed operators in the provision of fixed to mobile calls through charging themselves a much lower termination rate than they charge to third parties (suggesting that the ‘real’ mobile termination cost is likely to be lower than regulated rates to date). This has been a serious issue in the business service sector for a decade, and is becoming a more widespread problem as integrated incumbents and large mobile operators offer fixed mobile converged services in which they offer fixed to mobile calls at a ‘fixed’ price and in some cases using a ‘fixed’ geographic number.
- Fixed operators are prevented from offering consistent and/or flat-rate retail packages for calls to all numbers (in particular including calls to mobiles), whilst large mobile operators in particular are able to benefit from the low regulated fixed call termination rates to offer packages which include attractive retail tariffs for calls to fixed networks (throughout the EU) as well as other calls.

Clearly ECTA would not wish for consumers and business users to be deprived of innovative services, in particular flat-rate packages, or to undermine the development of fixed mobile convergence and – ultimately – number portability between fixed and mobile numbers. Our aim is to ensure that there is a level playing field in which all efficient operators have an equal opportunity to participate – and innovate. This is not the case where large mobile operators are allowed to adopt discriminatory practices to maintain and strengthen their competitive position, and the problem is compounded in circumstances where discrimination in spectrum allocation and/or lack of real MVNO access prevents entry and innovation by smaller mobile and fixed players in fixed mobile converged services.

⁷ WIK study, *supra* footnote 3, at p. 67.

⁸ CERNA-Warwick-WIK, *supra* footnote 6, at p. 52

The on-net problem in mobile is also a risk for fixed⁹

In addition to regulatory action with regard to asymmetry of (mobile) termination, a strong signal should be sent to regulators and incumbents that the type of discrimination described above, which is prevalent in the mobile sector, should not be tolerated for dominant players in the fixed environment. If a fixed incumbent with 70-80+% of the access lines offered free or lower retail 'on-net' tariffs, it would seriously undermine the viability of competitors in the voice and access line markets. Yet, this could become a reality if regulators stop examining retail calls markets following the removal of those markets from the Recommendation.

ECTA considers that this effect has been allowed (to date mainly in mobile markets) through a failure to enforce a remedy commonly applied in relation to wholesale call termination – non-discrimination. Effective non-discrimination applied on local loop unbundling for example should mean that the dominant operator supplies unbundled loops on equivalent (or indeed the same) price, terms and conditions to third parties as it does to its internal divisions. Yet few checks are made that this rule is applied as regards wholesale termination provided by operators with a comparatively large customer base. On-net retail tariffs offered by the largest operators which are lower than wholesale termination rates offered to third parties should for example provide a clear signal that products are not being supplied on equivalent terms and thus that the terms of the wholesale product should be reviewed and possibly revised.

ECTA emphasises that this is not a retail issue. Instead, there is a need, enabled by the regulatory framework, for NRAs to monitor retail market behaviour and its consistency with wholesale obligations, prices and terms, e.g. by means of cross-checks whether wholesale obligations to supply cost-based wholesale termination on a non-discriminatory basis are being complied with.

Symmetry versus effective cost orientation

Cost orientation for early and late entrants

The draft Commission Recommendation states that NRAs should set symmetric wholesale termination rates based on the costs incurred by an efficient operator.

The fundamental principles contained in the EU Regulatory Framework of non-discrimination, technological neutrality and promotion of competition and cost recovery imply in general that all operators should be treated in a similar manner in similar circumstances and be allowed to recover their costs in order to promote fair and sustainable competition. Furthermore, the principle of technological neutrality implies that regulators cannot favour specific operators and technologies by allowing some operators the ability to fully recover costs (or even over-recover, as is undoubtedly the

⁹ ECTA is referring explicitly to on-net off-net discrimination which cannot be justified through different input costs (although in certain circumstances where competition is very nascent it may be appropriate also to require the averaging by the dominant player of termination rates within its retail price)

case today for the largest mobile network operators) and denying this possibility to others.

In this respect, the concept of symmetry should be intended as **the application of similar remedies in similar circumstances rather than the application of the same remedy in different circumstances**. Therefore, the application of symmetry of wholesale termination rates is a possibility but only in case there is an effective equivalence of circumstances and it is justified by an objective alignment of underlying costs. The circumstances that need to be considered are:

- Time of entry and time to reach efficient scale
- Market fluidity (switching tendencies in mature markets)
- Late entry-related costs (including costs that may be required to encourage switching)
- Technological differences
- Differences in risk profile and cost of capital
- Differences in the competitive landscape taking account historic advantages and regulation (is there a level playing field that allows the entrant to meet other assumptions? Are there costs (such as those relating to rights of way) that are faced by an entrant which were not applicable to incumbent/(s))
- Network investments of altnets (fixed and mobile) has a significantly minor degree of depreciation vs incumbent operator or early mobile entrants
- Amortisation of sunk costs over (un)equivalent periods of time
- Possibility of splitting costs over a wider subscriber base

In view of the above listed objective and significant differences ECTA suggests that effective cost orientation be the principle instead of absolute symmetry. Effective cost orientation is the right tool in order to avoid competitive distortions and ensure that all operators in the market have incentives to make efficient investments. The imposition of symmetry by levelling all operators to the cost structure of the dominant operators is likely to result in distorting competition preventing cost recovery by alternative and non dominant operators, while incumbent operators and early entrant mobile operators would be the only ones able to recover their costs.

This was recognised by IBPT, the Belgian NRA in its latest remedies on the wholesale mobile termination market. IBPT imposed a price control remedy on all three mobile operators, which entailed a glide path towards cost oriented, asymmetric termination rates.

In reply to concerns regarding asymmetry IBPT pointed out, that its model reflects the fact that Belgacom Mobile, Mobistar and Base entered the market in 1994, 1996 and 1999 and that the respective costs of the three SMP operators are different. IBPT recognised that '[t]his situation requires a different treatment, in light of the principles of economic efficiency, sustainable competition and consumers' interests and protection. In addition, IBPT underlines that a quicker reduction of MTR could have an overall negative impact on the development of competition on the mobile market, which would be detrimental to Belgian consumers.'¹⁰

¹⁰ Commission comments letter, 'Case BE/2006/0433: voice call termination on individual mobile networks in Belgium, Comments pursuant to article 7(3) of Directive 2002/21/EC' of 4.8.2006, pp. 4-5

The temporary asymmetry of new entrants' wholesale termination rates should not be considered *entry assistance policy* if the asymmetry is based on cost orientation, but as a tool to ensure non-discrimination and a level playing field. Incumbents have been able to recover their costs and make a fair return on their investment. Large mobile operators have been and are still able to make substantial profits through their allegedly cost oriented wholesale termination rates. Disallowing new entrants the opportunity to recover merely their costs is seriously distorting competitive conditions and favours incumbents and large mobile operators.

Efficiency and exogenous factors

ECTA agrees with the goal to ensure that all operators are producing efficiently and that the right of new entrants to recover their costs should be reconciled with the regulatory objective of achieving the maximum level of efficiency in the supply of wholesale termination services. Nevertheless, it is important to highlight that the concept of efficiency needs to be evaluated in the light of the objective economies of scale and scope, levels of investments, type of architecture, market share, historic distortions (including those resulting from regulation or non-regulation), etc.

In this context, we are concerned that the notion of efficiency as currently defined in the Recommendation favours the incumbent operator and punishes the later entrants for not having reached the "efficient" level (see in annex the BIPT decision of December 2007 and the decision of the Brussels court suspending this decision). This ignores the historic development of the market, the principle of cost orientation and the principle of liberalisation. More importantly, weakening the challenger operators will turn the prediction of the large operators into a self-fulfilling prophecy: and without competitive development markets will further consolidate and retail prices will certainly go up.

The only example given in the Draft Recommendation and the accompanying Staff Working Document of objective cost differences which are outside the control of an operator and can justify asymmetry are related to uneven spectrum assignments¹¹. ECTA agrees that later entrants to the mobile market often face higher unit cost due to the different propagation characteristics of the spectrum they were able to obtain and this is an exogenous cost difference outside their control. However, there are a number of additional exogenous factors described below.

Similarly, there are exogenous factors that fixed new entrants can hardly influence, which should equally be taken into account by the Draft Recommendation. For example the Commission stated that fixed entrants have more control over their network structure in particular the geographic area they choose to cover and the possibility to lease network services from incumbents. There are two very important aspects of new entrants' network structures, however that are outside of their control. When alternative operators roll out their networks they are forced to adjust it to the incumbents' architecture in order to ensure adequate interconnection and the lowest possible wholesale termination costs. The number of points of interconnection are clearly determined by the incumbents' PSTN architecture and are most likely result in a network structure that is not the most effective one from the new entrants' perspective. The other

¹¹ Draft Recommendation p. 8 paragraph (8); Draft Commission Staff Working Document accompanying the Draft Recommendation, p. 17

objective characteristic of fixed networks is that they are less scalable to actual traffic volumes than mobile networks although the efficient structure of the network is also dependent on volume. Therefore economies of scale in fixed networks are higher, resulting in higher cost imbalances between networks of different sizes, with “sizes” being defined by traffic volume and not necessarily geography.

Other issues which determine the ‘efficient’ operation for both fixed and late entrant mobile operators are as follows:

- The Recommendation introduces a regulation that depends on the level of output, i.e., reaching a certain level of market share in a market different from the regulated market of termination rates; In the fixed market this would be the market share used for calculation of the dominant incumbent’s rates, whilst in the mobile market it is suggested to be 1/number of operators. There is no real basis to conclude that this should be the case and this assumption is certainly not confirmed by the facts in the industry. In mobile markets market shares of first and later entrants are substantially different and have been frozen for several years, with no real outlook on an immediate change. Equally there is a substantial and persisting asymmetry of retail fixed market shares whereby the market position of incumbents in broadband and voice line provision seems to have been frozen or is even increasing in some major countries.
- The Recommendation does not consider whether the market for call origination is competitive and there are equal opportunities for customer acquisition by all operators. If there are competitive problems in these areas, which have not been addressed through effective regulation, a penalty for not reaching a certain market share would be highly inappropriate.
- The Recommendation does not consider that for entrants the tendency to have higher per unit costs in acquiring customers may have been the only possible outcome in view of market conditions from a business and economic point of view. Later entrants will inevitably face problems with customer inertia in a mature market which are not faced by earlier entrants. Equally the Recommendation does not acknowledge the need for later entrants to set lower retail prices in order to attract customers to switch. Both higher acquisition costs and lower revenues are a ‘cost of late entry’ into mature markets, which are outside operators’ control and create different overall business costs for incumbents and later entrants.
- The Recommendation does not consider that costs per minute strongly depend on number of subscribers and call volume (economies of scale) and that therefore there are different cost levels for different market shares. Operating at a low scale does not mean that the operator is inefficient if the market conditions do not allow the operator to reach a higher scale.
- The Recommendation does not acknowledge that the application of this principle with the current asymmetric market shares and traffic flows will lead to financial transfers from smaller to larger operators, i.e., an over recovery and excessive profits for first entrants and an under recovery and penalty for later entrants,

which will not stimulate competition. This point was acknowledged by the Brussels Court of Appeal when it suspended the BIPT decision on market 16:

The Belgian court, in overturning the Belgian regulator's decision on MTRs found symmetric termination and the use of the Commission's definition of an efficient operator (having 33% market share) negatively affects competition:

“Consequently, the adoption of such a method for the evaluation of the costs leads,[...], to the application by Belgacom Mobile of excessively high prices with regard to its real price structure, which is prohibited by the concept of orientation of prices to costs (CJCE, judgment of 13 July 2006, Mobistar, C-438/04, Rec. P I-6675, point 35).

[...]On this supposition, it also does not appear that the IBPT tried to counter the thesis defended by Base and Mobistar according to which the differences in market shares and/or the cost differences with regard to Belgacom Mobile result from a series of exogenous elements which they cannot control. Indeed, a low market share does not automatically reveal inefficiencies of the weaker operator. It can also reveal the presence, on the market, of obstacles to the development of competition.

The disputed decision does not explain why the elimination of the differentials of termination charges in a direction favourable to Belgacom Mobile, which is authorised to increase its tariffs to a level higher than the level of its real costs as defined on the basis of generic model developed by the IBPT, is supposed to meet the concern of the IBPT for remedying the problems of competition identified in the decision of 11 August 2006, namely: (i) the high level of termination prices in absolute terms which at least according to the Institute is reflected in the retail prices of the off net calls arriving on the network of the mobile operator applying the high prices, (ii) the presence of cross subsidies and the risk considered to be sufficiently high with regard to Belgacom Mobile and Mobistar that this practice distorts competition in the retail market, (iii) a strong tariff differentiation between on net calls and off net calls as well as retail tariffs which are abusively low on net calls, and finally (iv) a lack of transparency of retail prices which do not reflect the costs, which is assumed to be the case with the prices for mobile services (in particular on net) relative to the prices for fixed services (in particular off net).”

In a letter to the Commission, the Belgian regulator, BIPT, expressed its concern with the symmetrical regulation of MTRs:

“Our Institute has considered the risks related to such an approach, based on the rating symmetry principle, which has the effect of strengthening the position of the incumbent operator and to undermine those of its principal competitors, although one of the fundamental objectives of the regulatory framework is the promotion of competition (article 8 of the "Framework" guideline). It seems clear that the potential eviction from the market of one of its principal players (Base?) which could result from these regulation mechanisms would probably be the worst case scenario in terms of maintaining effective competition on the telecommunications market in Belgium”.

- Allowing first entrants to continue charging above cost termination rates will allow them to continue setting low on-net rates to lock in customers and applying price squeeze practices that will restrict competition.
- The Recommendation does not consider that asymmetrical rates may actually be better for competition and consumer welfare.

Inefficient entry

The Commission raised concerns that asymmetric wholesale termination rates may attract *inefficient entry*¹². The risk that asymmetry may represent a reward for small size and provide inappropriate investment incentives and therefore promote inefficient entry is only theoretical and does not exist in practice. Operators have much stronger interest in growing and gaining market share than remaining small only to take advantage of higher termination rates. Also, if termination rates are genuinely cost oriented and do not allow for extra profits (which is the case for entrants today where objective entrant costs have been calculated), there is no incentive for operators to remain small only to enjoy increased profitability. Therefore, there will always be strong incentives to invest and expand. This is evidenced by the current investment figures of alternative operators. Today new entrants recover a portion of their costs through asymmetric wholesale termination rates in several Member States, yet they invest on average twice as much in proportion to their revenues as incumbents.

Disincentive to innovate

The Commission has expressed concerns that the asymmetry of wholesale termination rates may act as a *disincentive to smaller operators to innovate*¹³. There is ample evidence to the contrary. Indeed it is challengers of incumbents who have very strong incentives to offer innovative products in order to be able to compete with the well established network operators who have larger coverage, better financial assets, well known brands etc. Indeed, it is only through offering innovative services and competitive prices that new entrants can hope to counter subscriber inertia to switching service providers. Examples of innovative products introduced by alternative operators are:

- o Dial-up Internet
- o Flat-rate Dial-up Internet
- o Flat-rate national calls (fixed) or Happy Hour type offers (cheaper / flat at certain hours)
- o Take your wifi phone with you and use another person's BB/Wifi to make outgoing fixed calls (for free in flat-rate)
- o SDSL ATM bitstream (QSC)
- o Fastweb was the first to launch IPTV in the Italian market
- o Cable companies were the first to launch broadband services
- o Innovative bundled offers (for example free includes international fixed calls to 70 countries in its bundle sold for 30 Euros also including broadband, IPTV, VoD, etc.¹⁴)

¹² Draft Commission Staff Working Document accompanying the Draft Recommendation, p. 16

¹³ Draft Commission Staff Working Document accompanying the Draft Recommendation, p. 16

¹⁴ <http://www.free.fr/adsl/telephone.html>

Traffic imbalances

Regarding *traffic imbalances*, ECTA agrees that these should not justify asymmetry *per se*¹⁵. If an operator has more outgoing than incoming traffic due to imbalanced traffic flows but termination rates are effectively cost oriented on both sides, there is no competitive distortion deriving from the traffic imbalance since all operators are able to recover the effective costs incurred.

Traffic imbalances coupled with termination rates above effective costs, however, cause serious competitive distortions and are liable for significant net financial transfers between operators also recognised by the Commission.¹⁶ These net transfers currently derive primarily from the fact that wholesale mobile termination charges are not effectively cost oriented, therefore fixed operators and small mobile operators subsidise incumbent / early entrant largest mobile operators without any cost justification thereby distorting competition on the retail market and depriving the originating operators of financial resources, which could be otherwise used for their own investments or commercial strategies.

Equally, if symmetry of wholesale termination rates is the absolute rule, incumbent operators / early entrant largest mobile operators are likely to continue to over-recover or at least recover their costs, while new entrants will not be able to recover their costs, their costs not being the same as the incumbent's or of the early entrant largest mobile operators. This coupled with the fact that the preponderant part of calls originated at a new entrant's network is terminated on the incumbent's / early entrant largest mobile operators' network, (i.e. significant traffic imbalances) will be liable for net transfers from new entrants to incumbents / early entrant largest mobile operators.

Presumption of symmetry reinforces existing advantages for incumbents and early entrants

Incumbent operators of fixed networks and early entrant mobile network operators have been allowed to recover costs for network build-out in the initial phase through retail prices in a monopoly regime (for fixed networks) and often a temporary monopoly followed by a long period of duopoly for mobile networks and post-liberalization via high wholesale termination rates that have allowed them to fully recover their investments many years ago.

Incumbents' and early mobile entrants costs for call termination are the costs of operators with a very high penetration rates and very high market share and call volumes and which have completed the network roll-out. Assuming the same level of termination rates for new entrants who in most cases are in a different situation in terms of market entry, level of network deployment, market share and call volumes would not only be discriminatory but would in fact represent a clear disincentive for network deployment and expansion by alternative operators.

¹⁵ Draft Commission Staff Working Document accompanying the Draft Recommendation, p. 17

¹⁶ Draft Commission Staff Working Document accompanying the Draft Recommendation, p. 14

Fixed entrants are (like late mobile entrants) in an early phase of investment

It is important to note that while it is true that, on the one hand, in about half of the EU Member States the liberalization process began almost 10 years ago and thus some alternative operators should not be considered still as “new entrants”, on the other hand, (i) effectiveness of liberalization measures was often delayed by many years (and remains unsatisfactory today in several Member States), and (ii) the type of competition has changed significantly over this time frame (carrier preselection, number portability, local loop unbundling, leased line terminating segments, bitstream access, migration/synchronisation, etc. etc. were introduced at far later dates and several of these have NOT been achieved in all Member States).

In the initial phases of competition, most operators entering the market were offering only switched voice services provided to end customers via carrier selection, and thereafter Internet dial-up using interconnection services enforced upon the incumbent. With the exception of a few countries with alternative cable infrastructure, direct access by alternative fixed operators did not exist until ULL started to be effectively available after 2002 (for example, in Italy although ULL was theoretically introduced in 1998, the first lines were unbundled at the beginning of 2002, whilst in the UK the effectiveness of ULL was delayed even longer).

New entrants are therefore still in the phase of deploying their infrastructure either to increase ULL penetration or by means of direct access to the customer and are still facing the disadvantages of not having reached the necessary economies of scale that will allow them to optimize the cost structure (not because of inefficiency but only due to the cost structure of the network deployment).

Inappropriate symmetry disincentivises competitive investment

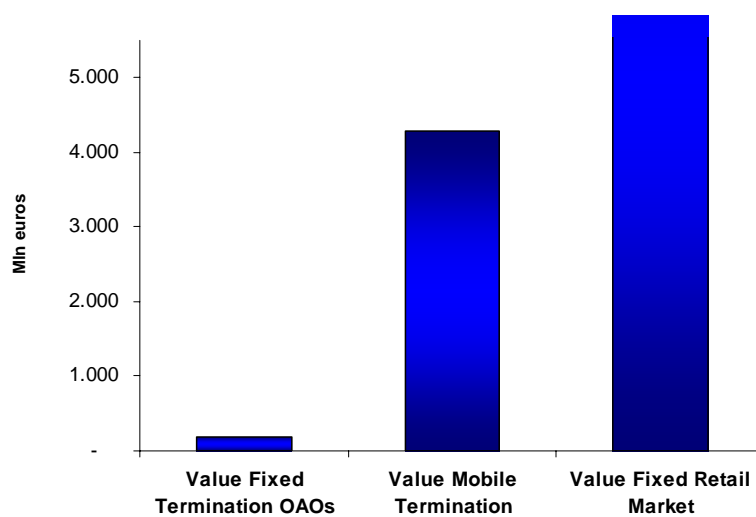
Imposing symmetric rates on later entrants based on the economies of scale, market shares and level of depreciation of the traditional networks of incumbent operators and early entrant mobile operators (in many cases fully depreciated), would seem not to be proportionate and represent a clear disincentive for an entrant to invest in its own infrastructure favouring instead the adoption of a resale-based competition model.

Impact on consumers of asymmetry for small operators is limited

With regard to the translation in higher retail prices for calling the alternative networks¹⁷, the focus should not be on the nominal values of the wholesale termination rates but rather to the overall amount (of calls and of money expected) which determines the impact on the retail market. Since especially in the fixed market, market shares of OAOs are limited, the overall impact of asymmetric wholesale termination rates on the retail market is limited if not negligible. We believe that because the very low OAO market shares of the termination market coupled with the relative closeness of OAO to incumbent termination rates, where asymmetry does exist, compared with the outcome for mobile rate asymmetry and its impact on fixed customers then the focus must be on mobile network asymmetry.

¹⁷ Draft Commission Staff Working Document accompanying the Draft Recommendation, p. 18

The figure below relating to Italy, a country in which the NRA has adopted asymmetry, illustrates how, regardless of the levels of the rates, the impact on the market is extremely limited.



By contrast, if competitors are allowed to recover a portion of their costs also via wholesale termination rates, invest and achieve market shares, it is inevitable that wholesale termination rates will decrease and so will the impact of asymmetries on the market whilst the presence of infrastructure based competition will bring benefits to consumers in the longer run.

With regard to the articles of the Recommendation, ECTA would like to make the following observations:

- (1) the focus should be mainly on the role of NRAs in ensuring cost orientation on all operators (fixed and mobile) based on the costs incurred by an efficient operator, taking nevertheless into account specific circumstances which may justify objective cost differences. In any case, even in these cases, NRAs should provide adequate incentives for the reduction of wholesale termination rates through for example the provision of network caps.

The Recommendation should therefore further highlight and stress the issue that NRAs need to enforce immediately genuine cost orientation on all operators, in particular on the early entrant largest mobile network operators, in order to avoid distortions of competition and forms of discrimination among market players.

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.

Comments on the Annex to the Draft Recommendation

ECTA suggests further clarification of the traditional *distinction between traffic related and non traffic related costs* and their adaptation to new technologies with particular regard to the characteristics of NGN networks. This affects also the traditional default demarcation point between traffic and non traffic related costs which is currently considered to be the first point of traffic concentration. While this may apply to traditional PSTN networks, it may not apply to NGN networks. Choosing a demarcation point that is based on a certain network architecture may therefore be misleading and contrary to the principles of cost causality and technological neutrality.

In order to make the Recommendation future proof ECTA suggests that the principles to be considered by NRAs in the definition of allowable costs take a neutral approach.

Regarding the determination of the *efficient scale of an operator*, while it is true that in some cases fixed network operators may choose to limit operations to specific local areas where they may achieve some level of economies of scale, it would be misleading to limit the analysis to small scale operators since this would promote only limited forms of competition on a local/regional scale and no serious level of competition at a national scale. The consideration that in case smaller operators that cannot match the economies of scale of the largest operators over broader geographical areas can be assumed to purchase wholesale inputs rather than self provide termination services also, in ECTA's view, needs to be reconsidered since if implemented incorrectly may lead to a disincentive for investments by altnets and therefore undermine efficient infrastructure based competition on a wider geography.

When determining the efficient scale of operators NRAs also need to take into account the fact that new entrants are forced to adjust their networks to the incumbents' PSTN network, which determines their number of points of interconnection. NRAs should also take into account the limited scalability of fixed networks to actual traffic volumes compared to mobile networks.

Cost models

ECTA supports the consistent treatment of fixed and mobile networks' costs in line with the principle of technology neutrality and non-discrimination.

ECTA expects that the approach outlined in the Draft Recommendation will put an end to inconsistencies between the cost regulation of fixed and mobile wholesale termination services existing today.

Coverage costs

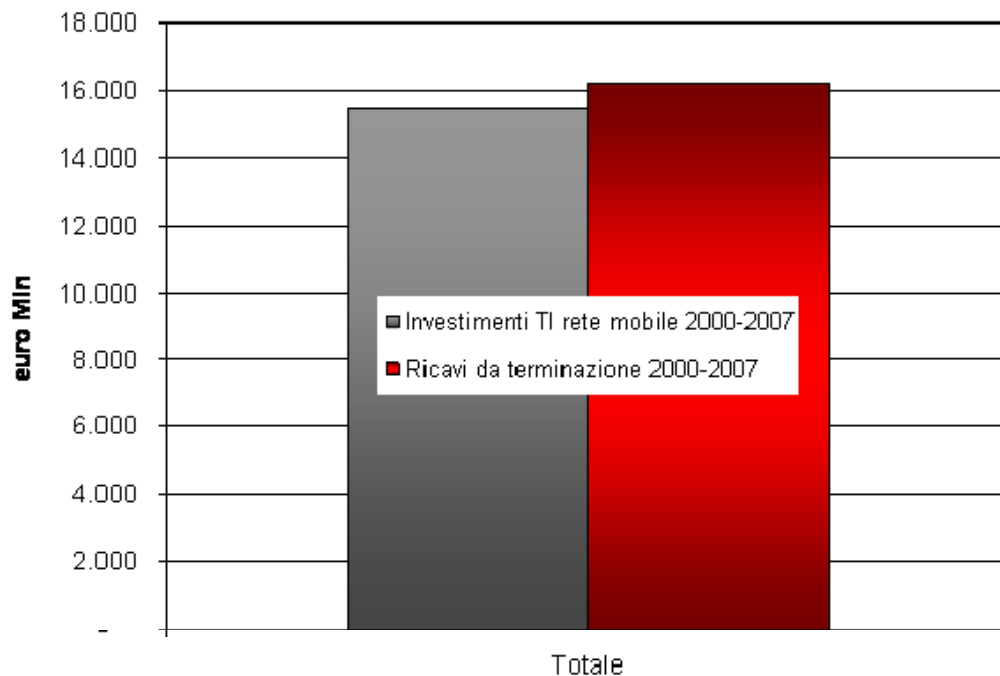
ECTA agrees with the approach that only the additional network capacity needed to transport additional wholesale traffic (the traffic that results from the provision of wholesale termination services to third parties) is included in the increment of wholesale mobile termination rates. Indeed the inclusion of the radio access networks' cost has created competitive distortions between mobile and fixed operators.

Today access costs are not allowed to be included in fixed networks' wholesale termination charges based on the assumption that access costs are recovered via retail line rental charges. Mobile network operators on the other hand are currently allowed to include access costs in their wholesale termination charges, which allows mobile operators not to charge a monthly fee but only pay as you go charges.

Spectrum costs

ECTA also agrees that the costs of spectrum usage (the costs of acquiring, retaining and using spectrum) are first and foremost related to providing retail services to network subscribers and not causally linked to wholesale termination services. These costs are not traffic driven, except for the additional spectrum acquired to increase capacity in order to provide wholesale termination services to third parties. NRAs should verify, however, whether the spectrum costs included in wholesale mobile termination charges are in fact incurred due to wholesale termination traffic attributable to interconnection with third parties.

Mobile network operators have benefitted from non cost oriented wholesale termination charges, which have already allowed them in many cases to fully recover their investment costs including the costs of their 3G licences. It is apparent from the balance sheets of Telecom Italia Mobile for example that the revenues derived from wholesale termination charges during the period 2000-2007 have been well in excess of the total investments of the company made during the same period (which have also included the costs of the 3G licence in 2000).



Source: balance sheet and financial data Telecom Italia/TIM 2000-2007

4 Forward looking issues

Bill & Keep and migration to IP Interconnection

In the US, the combination of the requirement to interconnect and operators to negotiate termination rates among themselves, the principle of reciprocity and a wholesale cap often led operators to set wholesale termination rates at zero and apply Bill & Keep.

ECTA's members have identified a set of arguments both in favour and against the Bill & Keep (B&K) wholesale charging regime in an IP interconnection environment. It seems clear that further analysis is necessary on the practical implications of introducing B&K in Europe before robust conclusions can be envisaged.

On a preliminary basis in circumstances where the glidepath to symmetric termination rates has been reached, regulated B&K between the incumbent and smaller fixed competitors could be appropriate in addressing the dominance of the incumbent due to its significantly higher share of subscribers in an NGN context. It would be reasonable in this case to stipulate a minimum number of interconnect points to protect incentives to invest. Elsewhere, it seems that operators with equal or very similar bargaining power (i.e. similar customer base and traffic) should be able to agree bilaterally on their favoured wholesale charging regime and do not need to be subject to ex ante regulation in this respect.

For transit there would still need to be a revenue flow, albeit probably net bandwidth / sessions related rather than each party paying gross on a price per minute basis.

Alternative approaches – the US mobile market

There have been assumptions made in the press by large mobile operators that the accounting principles foreseen by the Draft Recommendation would lead to the Receiving Party Pays (RPP) system in Europe¹⁸. Although the Draft Recommendation does not attempt to impose any alternative approach to the current wholesale and retail charging mechanisms, it is worth investigating the impact of these systems on consumers and the development of the mobile market.

An argument often put forward by large mobile operators is that European customers are reluctant to pay for receiving calls. This would certainly be the case if European mobile customers were billed for incoming calls on a per minute or per second basis.

In the US, however, mobile operators offer bucket plans, which include a certain – usually large or unlimited number – of minutes that can be used for both making and receiving calls. The unit cost of any additional minute (beyond the large bucket) is far cheaper than in Europe. Due to the generous bucket plans and the very low per minute prices, US consumers do not perceive that they pay for incoming calls. What they perceive is that their plans allow them to make and receive as many calls as they want and in the rare case they make or receive beyond the plan the additional cost is low.

¹⁸ <http://www.ft.com/cms/s/0/676e0ab8-777f-11dd-be24-0000779fd18c.html>
http://www.theregister.co.uk/2008/09/01/voda_termination_submission/

This is evidenced by the fact that US mobile customers use their mobile phones far more than their European counterparts. The average usage per wireless handset is 832 minutes/month in US and only 149 minutes/month in Europe.

In addition US customers can use their cheap bucket minutes in most cases to make calls nationwide without facing international calling charges and incurring roaming charges, i.e. they can use their buckets of minutes to reach, and be reached by, a multitude of the number of correspondents that EU customers can.

The affordability of mobile tariff packages depends to a large extent on the tailoring of products to the needs of different types of user groups. The needs of those who are rather receivers than call makers and of low income users are both addressed by a variety of retail offers in the US.

For example the buckets of minutes can be shared between two or more people thus making smaller number of minutes available at low per unit prices for each user, which is budget friendly for families, grandparents etc.

Prepaid plans allowing greater control for consumers' over their spending on mobile services are equally available in the US.

Those consumers who are rather receivers than makers of calls can opt for plans that charge only for outgoing calls.

Mobile penetration rates are similarly high in the US – currently at 84% - as they are in Europe and have just outgrown Europe in terms of 3G subscribers¹⁹.

¹⁹ <http://www.telecompaper.com/news/article.aspx?cid=634606>