



# **The Authority's response to the Commission Recommendation on the regulatory treatment of fixed and mobile termination rates in the EU**

**Response to Consultation 08/08**

**1<sup>st</sup> September 2008**

**Gibraltar Regulatory Authority**

Suite 603, Europort

Gibraltar

Telephone +350 20074636 Fax +350 20072166

Web:<http://www.gra.gi>

# CONTENTS

<b>Executive Summary .....</b>	<b>1</b>
<b>1. SMP obligations on termination services in Gibraltar .....</b>	<b>2</b>
1.1 Call termination on the Gibtelecom public telephone network at a fixed location.....	2
1.2 Wholesale voice call termination on the Gibtelecom mobile network .....	3
1.3 SMS termination on the Gibtelecom mobile network .....	4
<b>2. The EC Draft Recommendation.....</b>	<b>6</b>
2.1 Introduction.....	6
2.2 The main elements of the EC draft Recommendation.....	6
<b>3. Comments on the Recommendation .....</b>	<b>8</b>
3.1 The Authority's comments.....	8

## Executive Summary

This statement presents the Authority's position on the European Commission's proposed Recommendation on the regulatory treatment of fixed and mobile termination rates in the EU.<sup>1</sup> The response also summarises the current regulatory treatment of fixed and mobile termination rates in Gibraltar.

The Authority has imposed SMP obligations on Gibtelecom in the following markets:

1. Call termination on the Gibtelecom public telephone network at a fixed location (Market 3 in Commission Recommendation 2007/879/EC); and
2. In the wholesale voice call termination on the Gibtelecom mobile network (currently branded Gibwireless) in Gibraltar (Market 7 in Commission Recommendation 2007/879/EC); and
3. In the wholesale SMS termination on the Gibtelecom mobile network (currently branded Gibwireless) in Gibraltar

The purpose of this statement is to enhance transparency and increase legal certainty for market players.

The statement is structured as follows:

Chapter 1 describes the SMP obligations on termination services in Gibraltar.

Chapter 2 summarises the EC draft Recommendation of the regulatory treatment of termination rates.

Chapter 3 presents the Authority's Comments on the Recommendation proposed by the European Commission.

---

<sup>1</sup> Draft Commission Recommendation on the regulatory treatment of fixed and mobile termination rates in the EU, 26 June 2008.

# 1. SMP obligations on termination services in Gibraltar

This document sets out the Authority's position on the European Commission's proposed Recommendation on the regulatory treatment of fixed and mobile termination rates in the EU.<sup>2</sup> The response also summarises the current regulatory treatment of fixed and mobile termination rates in Gibraltar.

The Authority has imposed SMP obligations on Gibtelecom in the following markets:

1. Call termination on the Gibtelecom public telephone network at a fixed location (Market 3 in Commission Recommendation 2007/879/EC); and
2. In the wholesale voice call termination on the Gibtelecom mobile network (currently branded Gibwireless) in Gibraltar (Market 7 in Commission Recommendation 2007/879/EC); and
3. In the wholesale SMS termination on the Gibtelecom mobile network (currently branded Gibwireless) in Gibraltar.

## 1.1 Call termination on the Gibtelecom public telephone network at a fixed location

The following obligations will apply to Gibtelecom in this market according to Decision Notice 04/08:<sup>3</sup>

- Obligation of transparency
- Obligation of non-discrimination
- Obligation of accounting separation
- Price control and cost accounting obligations

With regard to termination rates the Authority has imposed the following obligations as part of the price control and cost accounting obligations:

1. Gibtelecom shall ensure that its prices are cost oriented.
2. Gibtelecom shall maintain cost accounting systems which produce appropriate information to demonstrate compliance with cost-orientation.

---

<sup>2</sup> Draft Commission Recommendation on the regulatory treatment of fixed and mobile termination rates in the EU, 26 June 2008.

<sup>3</sup> Decision and SMP Obligations – Wholesale Fixed Markets, Decision Notice No. 04/08, 11th August 2008.

## 1.2 Wholesale voice call termination on the Gibtelecom mobile network

The following obligations will apply to Gibtelecom in this market according to Decision Notice 03/08:<sup>4</sup>

- Access obligation
- Obligation of transparency
- Obligation of non-discrimination
- Obligation of accounting separation
- Price control and cost accounting obligations

With regard to termination rates the Authority has imposed the following obligations as part of the price control and cost accounting obligations:

1. Gibtelecom shall account separately for its voice call termination services business.
2. Gibtelecom shall set rates for mobile voice call termination as follows:
  - a. From January 1, 2009, the maximum price of the termination of a voice call on Gibtelecom shall not exceed 9.5 pence per minute.
  - b. From January 1, 2010, the maximum price of the termination of a voice call on Gibtelecom shall not exceed 8.5 pence per minute.
  - c. From January 1, 2011, the maximum price of the termination of a voice call on Gibtelecom shall not exceed 7.5 pence per minute.
3. Gibtelecom may vary the price of the termination of a voice call across discrete time periods.

The method used by the Authority for determining the above maximum termination rates was international benchmarking. The Authority noted during its market review that the "true long run incremental cost of mobile [voice] call termination is no higher than 8.25ppm".<sup>5</sup> However, the Authority has not been provided to date with a LRIC estimate for mobile voice call termination by Gibtelecom.

The European Commission in its comments on the Authority's notification commented on the proposed SMP price control:<sup>6</sup>

"The Commission notes that MTRs [Mobile Termination Rates] set by the GRA for the three-year period appear to be above the European average." The SMP obligation

---

<sup>4</sup> Decision and SMP Obligations – Wholesale Mobile Markets Decision Notice No. 03/08 11th August 2008.

<sup>5</sup> Response to Consultation and Notification to European Commission – Wholesale Mobile Markets (Response to Public Consultation 03/07), Document No. 15/07), 31 October 2007, page 46.

<sup>6</sup> See SG-Greffe (2007) D/207396, letter sent to Mr. Paul Canessa, CEO of the Authority, 30 November 2007.

applied by the Authority shall lead to termination rates not exceeding 7.5ppm by 2011.

The Authority notes that the weighted average termination rate in the EU at 1 January 2008 was 7ppm.<sup>7</sup> It is likely that by 2011 this average will be closer to 5ppm, given the SMP obligations applicable in Member States.

More recently the Authority has estimated that the weighted average mobile call termination is 9.58ppm, some 26% above the EU average.<sup>8</sup>

The Authority also presented its position on the likely SMP obligation that would be applied to a new entrant mobile network operator, should it be designated as having SMP in the relevant market. The Authority stated that it:

“would likely propose a price control obligation identical to that applied to the incumbent [Gibtelecom] – there would be symmetric application of price control”.<sup>9</sup>

The Authority presented its reasons for adopting symmetric price control.

### **1.3 SMS termination on the Gibtelecom mobile network in Gibraltar**

The following obligations will apply to Gibtelecom in this market according to Decision Notice 03/08:<sup>10</sup>

- Obligation of transparency
- Obligation of non-discrimination

With regard to termination rates, the Authority has not imposed any price control obligations.

In addition to the above, the Authority has also published guidelines in the form of a Statement on certain aspects of cost accounting which are intended to enhance transparency and increase legal certainty for market players.<sup>11</sup> The Statement provided all stakeholders guidance on:

- (i) Accounting separation obligations;
- (ii) Cost orientation obligations;

---

<sup>7</sup> The weighted average was 7.05ppm using the rates of exchange and data presented in ERG (08) 17 MTR update snapshot final, 4 June.

<sup>8</sup> Annex to Decision and SMP Obligations – Wholesale Mobile Markets Decision Notice No. 03/08 11th August 2008.

<sup>9</sup> Response to Consultation and Notification to European Commission – Wholesale Mobile Markets (Response to Public Consultation 03/07), Document No. 15/07), 31 October 2007, page 67.

<sup>10</sup> Decision and SMP Obligations – Wholesale Mobile Markets Decision Notice No. 03/08 11th August 2008.

<sup>11</sup> Accounting separation, cost orientation, cost accounting methods and compliance under SMP obligations, Statement 07/08, 11th August 2008.

- (iii) Cost accounting systems necessary to produce the appropriate information to demonstrate compliance with cost-orientation as applied in the following wholesale fixed markets:
- Call origination on the public telephone network at a fixed location in Gibraltar
  - Call termination on individual public telephone networks at a fixed location in Gibraltar
  - Wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location in Gibraltar
  - Wholesale broadband access
  - Wholesale terminating segments of leased lines, irrespective of the technology used to provide leased or dedicated capacity; and
  - Compliance requirements.

The Statement in particular makes clear:

“The Authority prefers, for the purposes of enforcing SMP obligations requiring cost orientation, to apply the concept of Long Run Incremental Cost (LRIC).”<sup>12</sup>

---

<sup>12</sup> See section 2, Statement 07/08, 11th August 2008.

## **2. The EC Draft Recommendation**

### **2.1 Introduction**

The European Commission has proposed a Recommendation on the regulatory treatment of termination rates. The EC states that the Recommendation aims to:<sup>13</sup>

- Support a stable and balanced regulatory environment which provides efficient investment incentives, promotes a level playing field between operators, and facilitates further reductions in termination rates to the benefit of European consumers.
- Achieve more consistent regulation of call termination markets both within and across the Member States and thereby provide greater legal certainty to all.
- Provide clear and consistent principles on the effective regulation of fixed and mobile termination rates in the EU.

The Authority applauds these principles, but notes that it does not follow that termination rates would necessarily converge to a very narrow band as a result of the Recommendation.

### **2.2 The main elements of the EC draft Recommendation**

The Authority notes that the Commission's Recommendation would mean that:

- The Authority should set symmetric termination rates based on the costs incurred by an efficient operator;
- That the evaluation of efficient costs should be based on current costs and the use of a bottom-up modelling approaches using long-run incremental costs (LRIC) as the relevant cost methodology;
- The cost model should be based on efficient technologies available in the timeframe considered by the model. The core part of both fixed and mobile networks should therefore be Next-Generation-Network (NGN)-based. The access part of mobile networks should also be based on a combination of 2G and 3G telephony;
- Within the LRIC model, the relevant increment should be defined as the wholesale voice call termination service provided to third parties;
- The recommended approach for asset depreciation is economic depreciation wherever feasible;

---

<sup>13</sup> See [http://ec.europa.eu/information\\_society/policy/ecomms/library/public\\_consult/termination\\_rates/index\\_en.htm](http://ec.europa.eu/information_society/policy/ecomms/library/public_consult/termination_rates/index_en.htm)

- 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;
- The Authority 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;
- The Authority should ensure that termination rates are applied at a cost-efficient, symmetric level by 31 December 2011. Asymmetries that are currently applied should be phased out by that date, subject to any objective cost differences;
- In the event that the Authority is not in a position to finalise the recommended cost model in a timely manner and where it is able to demonstrate that a methodology other than a bottom-up LRIC model based on current costs results in outcomes consistent with the Recommendation and generates efficient outcomes consistent with those in a competitive market, an Authority could consider setting interim prices based on an alternative approach until 31 December 2013. Such an outcome should not exceed the average of the termination rates set by EU NRAs implementing the recommended cost methodology.

### 3. Comments on the Recommendation

#### 3.1 The Authority's comments

*The Authority should set symmetric termination rates based on the costs incurred by an efficient operator*

The Authority agrees with this position in principle and has stated publicly that the use of LRIC in the application of SMP obligations in Gibraltar should be on the basis of forward looking costs incurred by an efficient operator. The Authority has not determined in detail how an efficient operator is to be calibrated, but it is likely international benchmarking and engineering based studies could be employed.

*The evaluation of efficient costs should be based on current costs and the use of a bottom-up modelling approaches using long-run incremental costs (LRIC) as the relevant cost methodology*

The Authority has stated that LRIC computations normally should take a cost base calculation using current cost methodologies. The Authority notes that CCA methods require assumptions to be invoked with regard to many variables. It is likely in practice that CCA estimates may vary markedly with respect to these assumptions.

The Authority has also stated that it prefers the application of a top-down approach which takes as a primary data source an operator's accounting information, and calculates the costs of the relevant increments (normally at component or product group level). In constructing such accounts the Authority has expressed a preference for forward looking cost basis such as Current Cost Accounting.

The Authority notes that a bottom-up approach can be described as an engineering type model, which starts with the demand for the service/product included in the increment and initially uses dimensioning algorithms to build an efficient engineering network that can address this demand and then to assess the use of each network element to the different services of the increment.

The two methods may be used as complementary tools. The top-down model to determine the efficiently incurred costs of the SMP operator and the bottom-up model to check its efficiency. This method is referred to as the hybrid approach.

The Authority believes that a bottom-up approach in a territory as small as Gibraltar would not make economic sense. Therefore the Authority would prefer that the Commission amend its Recommendation to take account of regulatory resources and/or population size.

Furthermore, the Authority is concerned that a bottom-up approach using forward looking cost estimates based on CCA and the application of modern equivalent assets (MEA) might result in regulatory determined costs lying far from actual accounting costs reported to shareholders. This is especially likely in an industry where equipment costs are declining significantly.

The Authority is also concerned that if the risks associated with technology adoption decisions are not assessed adequately (in particular real option values are not adequately accounted for), investment decisions may be adversely affected and ultimately end users may suffer.

*The cost model should be based on efficient technologies available in the timeframe considered by the model. The core part of both fixed and mobile networks should therefore be Next-Generation-Network (NGN)-based. The access part of mobile networks should also be based on a combination of 2G and 3G telephony*

The Authority agrees with this in principle, though in the context of Gibraltar the comments made in the previous response apply.

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

The Authority notes that the LRIC increment can be defined in two complementary ways:

- It is the additional cost a firm incurs in the long run in providing a particular service as a whole, assuming all its other production activities remain unchanged;
- It is the total cost a firm would avoid in the long run if it ceased to provide the service.

The Authority accepts the proposed increment in principle. At present the SMP designated operator in Gibraltar does not provide wholesale products to third parties in the mobile market, yet price control regulation and cost orientation is an obligation placed on this operator. Therefore the increment to be used in determining LRIC values would be the service output that is self-supplied. The Authority has not, however, attempted to measure this LRIC value.

*The recommended approach for asset depreciation is economic depreciation wherever feasible*

The Authority believes that economic depreciation should be the method used to calculate depreciation values in the regulatory treatment of termination rates. Economic depreciation refers to the change in asset values based upon market prices rather than on historical costs. It better reflects underlying market signals and for regulatory purposes it is consistent with economic efficiency objectives.

*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*

The Authority in Gibraltar agrees with this and is proposing to apply symmetric voice mobile termination rates in the event another authorised operator is notified as having SMP in the relevant markets.

*The Authority 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*

The Authority has indicated its reservations above with regard to exclusive use of bottom-up cost modelling methods.

*The Authority should ensure that termination rates are applied at a cost-efficient, symmetric level by 31 December 2011. Asymmetries that are currently applied should be phased out by that date, subject to any objective cost differences*

The Authority accepts this position.

*In the event that the Authority is not in a position to finalise the recommended cost model in a timely manner and where it is able to demonstrate that a methodology other than a bottom-up LRIC model based on current costs results in outcomes consistent with the Recommendation and generates efficient outcomes consistent with those in a competitive market, an Authority could consider setting interim prices based on an alternative approach until 31 December 2013. Such an outcome should not exceed the average of the termination rates set by EU NRAs implementing the recommended cost methodology.*

The Authority would welcome the consideration of a relaxation of the deadline date 31 December 2013 in the case of small territories such as Gibraltar.