



Meteor Mobile Communications Ltd.

**Comment on the Draft European Commission
Recommendation on the Regulatory Treatment of
Fixed and Mobile Termination Rates**

10th September 2008

Meteor response to consultation: Draft European Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates

Meteor Mobile Communications Ltd (Meteor) welcomes the opportunity to Comment on the Draft European Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates. Meteor launched as the 3rd player on the Irish mobile market in February 2001. As at end June 2008, Meteor had 983,000 subscribers representing a subscriber market share of 19%. Speaking as a mobile operator our comments on the draft Recommendation will focus on the regulatory treatment of mobile termination rates.

Meteor has reviewed the draft Recommendation and the accompanying Explanatory Note and asks that account be taken of the following comments.

1. Justification for Recommendation

In the Explanatory Note the Commission states that "*The objective of the Recommendation is to define and set out clear principles on:*

- (a) the regulation of cost-oriented fixed and mobile termination rates in the EU, including common principles on the concepts of an efficient operator and symmetric regulation; and*
- (b) the identification and calculation of efficient costs consistent with those incurred in a competitive market"*

Meteor does not dispute that the aim of promoting consistency in the application of regulation is valid. Indeed as a commercial player in an aggressively competitive national mobile market we would welcome predictability in the regulatory framework. A degree of regulatory predictability is required in order to make informed investment decisions. Unfortunately the draft proposals fail to promote predictability. Meteor has already undertaken significant investment in rolling out its network. The investment decisions have been informed by forecasts of the contribution of revenue streams, including those from mobile termination, to generate a reasonable return on investment and recovery of operational costs. The Commission proposes to alter the business model but offers no explanation as to how operators can recover costs that would be disallowed in mobile termination rates ('MTR').

The proposals put forward by the European Commission ('the Commission'), in particular the proposed new definition of allowable costs, represent a fundamental change to the regulation of MTR across Europe. If implemented, the revised definition will have the effect of restricting the recovery of a significant proportion of legitimate costs that have to date been recoverable through MTR. Meteor acknowledges that Article 13 of the Access Directive specifically allows national regulators to impose obligations for cost orientation of prices on Significant Market Power ('SMP') operator. The regulatory framework does not however require that SMP operators should provide a service at a loss. We believe that the Commission has exceeded its authority in making these proposals particularly as it has not applied any rigour in analysing the economic effects on the competitive dynamics of national mobile markets.

Issuing a Recommendation that is so specific in nature and in conflict with established remedies, undermines the regulatory certainty that has been achieved through the established Regulatory Framework. National regulators have successfully applied the current framework and are in general achieving managed reductions in MTR. The inconsistencies that the Commission is proposing to address through the Recommendation could be addressed in a more predictable and managed way through the evolving regulatory framework as the framework has established the protocol for carrying out regulatory impact assessments that take account of distinct national market characteristics while in the case of

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SMP designations promoting the internal market. The Commission has already proposed¹ an increased involvement in decisions relating to remedies and it is not clear to Meteor how this proposed draft Recommendation can be justified instead of or in advance of this more structured alternative under the revised regulatory framework.

The proposals put forward by the Commission represent a radical departure from established regulatory practice and would have significant implications to competitive market dynamics. In our view the Commission has failed to conduct sufficient evaluation of its proposals and there is a significant risk that much of the competitive advances in the Irish mobile market achieved in recent years will be irreparably undermined. The Commission has failed to conduct an impact assessment and the Explanatory Note is little more than a qualitative discussion. The Commission has not in any way provided adequate justification for the proposals set out in the draft Recommendation. On this basis alone we ask the Commission to reconsider this initiative.

2. Definition of allowable costs

The Commission's proposal involves a radical new approach to the calculation of an efficient operator termination rate. By limiting the categories of costs that can be included in the MTR increment to capacity related costs, the Commission relies on assumptions about the nature of the mobile termination market that have not been objectively justified. In its treatment of coverage costs it disposes of established practice and the principles under-pinning calling party pays. Instead it assumes that the benefits delivered by ubiquitous coverage accrue solely to the called party. This is in spite of the fact that the ability of mobile networks to provide connectivity almost irrespective of the location of the called party is a well recognised externality that benefits calling parties as reflected by national regulators in their approach to MTR regulation and costing to date.

Meteor is still in the process of rolling out its GSM network and at the same time, only since 2007, has embarked on a capital intensive roll-out of 3G network services. The proposed radical changes to the EU business model undermine these investments and will impact on future business decisions. In the absence of any impact assessment by the Commission, if previously recoverable costs are disallowed what are the implications for market players, consumers, and European productivity? The Commission has failed to adequately justify why network operators should be precluded from recovering legitimate costs.

Meteor is concerned that the draft Recommendation poses a risk to the ongoing growth that Meteor has planned to achieve in the context of the glide paths for its MTRs as agreed with the national regulator. As national regulators will be required to take utmost account of the ultimate Recommendation, it creates an unacceptable degree of regulatory uncertainty which in itself is damaging to a newer entrant operator such as Meteor with respect to our ability to raise capital for continued investment in an ever increasingly capital constrained environment.

The Commission appears to believe that common costs including coverage costs should not be recovered from a regulated service. We question how this position can be reconciled with the fact that in many countries, Ireland included, coverage obligations have been attached to spectrum licences.

¹ Commission of the European Communities- Report on the outcome of the Review of the EU regulatory framework for electronic communications networks and services in accordance with Directive 2002/21/EC and Summary of the 2007 Reform Proposals (Brussels, COM(2007)696 rev1

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Meteor disagrees entirely with the Commission's one-sided view of mobile termination markets. In the Explanatory Note to the recommendation consideration is given to the two-sided nature of call termination markets however what is considered here is the possibility of refraining from applying all of the related costs to the wholesale termination charge. In the case of mobile termination it is recognised that a significant portion of coverage costs are included in MTR in addition to the incremental costs associated with the wholesale service. While this may leave scope for a rebalancing of the apportionment of common costs between network access, call origination and call termination, this does not provide justification for moving to the other extreme whereby call termination would bear an inappropriately small portion of common costs. However this is what the draft Recommendation proposes by suggesting that only the avoidable costs may be recovered. In taking this approach the Commission is ignoring the real benefit to calling parties of ubiquitous network coverage which warrants some contribution from the mobile termination increment. Meteor would urge the Commission to reconsider this aspect of the draft Recommendation in particular, given the long term social and economic impact of a flawed approach to both fixed and mobile markets.

The concept of a retail line rental charge or a retail access charge does not exist in European mobile markets. The Commission has given no consideration in its analysis as to how mobile operators can adjust to ensure cost recovery. Meteor as the third entrant in the Irish mobile market has brought vibrant competition to a previously stagnant duopoly market. It has achieved this by managing its costs efficiently and offering low margin retail prices. Meteor cannot therefore simply absorb the costs that would be disallowed from recovery through MTR. Then only option open to Meteor would be to increase its retail charges but this would place it at a competitive disadvantage relative to its main competitors Vodafone and O2 who are in a stronger position to absorb these costs at least in the short term. Vodafone and/or O2 could choose to absorb the costs for strategic reasons in order to detrimentally impact on Meteor and thereby dampen competition in the Irish mobile market. Is this what the Commission hopes to achieve with its proposals? We hope not, but the absence of any reasoned analysis by the Commission of the implications of its proposals causes us significant concern.

3. Inconsistencies between Member States

The Commission states that "*a considerable divergence between average termination rates, particularly as regards mobile termination rates, still exists across Member State*"². However the Commission fails to present any reasoned analysis to demonstrate that the current national regulatory regimes or the underlying business model are deficient. No consideration has been given to the fact that the costs of operating mobile networks will vary from country to country due to differences in geographical landmass, topography and population density. Neither is any consideration given to the fact that the cost of doing business in each Member State will vary. The cost of a loaf of bread differs between Member States and so will the cost of mobile termination services.

Even if it can be demonstrated that different national approaches towards cost orientation and the choice of costing methodology are contributing to the observed differences this is not adequate justification for radically altering the business model.

4. Divergences in the regulatory treatment between fixed and mobile

The Commission states that "*significant divergences in the regulatory treatment of fixed and mobile termination rates create a fundamental distortion between fixed and mobile markets*

² Explanatory Note, Section 1

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*and consumers.*³ The tone of the Commission's statement would suggest that this is considered to be a negative effect however no evidence is presented to substantiate this point by the Commission.

The Commission notes that MTR remain high compared to fixed termination rates generally. There are valid reasons why there are differences between the general levels of fixed and mobile termination rates. Meteor does not believe that there is a practical or objective justification for pursuing a regulatory policy to promote symmetry between fixed and mobile termination rates (nationally or on a broader basis). The economics of mobile and fixed networks are fundamentally different in respect of the access part of the network. Fixed telephony is provided to a consumer over a physical line (or point to point wireless link) to a single network termination point. In contrast mobile services are not tied to a single network termination point and must be provided nationally. The manner in which capacity is managed in the access part of the networks is also different.

The manner in which access network costs are recovered also differs between fixed and mobile networks and this contributes to the observed differences in termination rate price levels. Fixed consumers typically pay a retail charge for monthly line rental whereas mobile consumers do not. Fixed retail pricing has evolved in a micro-managed regulatory environment which has precluded the emergence of fixed pre-pay type services. Mobile retail prices have not been subject to similar micro-management. The retail pricing structures in national mobile markets have evolved under the current regulatory business model and have delivered significant consumer benefits in terms of service availability (coverage), quality of service, innovation, choice and competitive prices. No objective evidence has been produced by the Commission to suggest that the current regulatory business model is broken and hence there is no justification to attempt to artificially fix a consistency for the comparison of termination rates. The Commission's proposed definition of allowable costs, excluding coverage and other common costs would mean that fixed and mobile termination rates would be more directly comparable. Improving the ease of observing differences in fixed and mobile termination rates does not warrant the radical change and resulting disruption to the competitive dynamics of the mobile market proposed by the Commission.

The Commission's proposals will impact fixed markets to a significantly less extent than mobile markets. Re-balancing has occurred in fixed markets between retail line rental and call charges over the last decade, micro-managed by national regulators. As a consequence it is likely that fixed retail pricing is capable of adjusting retail charges to maintain cost recovery should certain cost categories be excluded from fixed termination and moved to line rental. However the Commission has failed to demonstrate whether the retail access charges are a desirable or necessary feature for the competitive evolution of fixed and mobile markets.

5. The application of symmetric rates

The Commission states that "*setting a common approach based on an efficient cost standard and the application of symmetrical termination rates would benefit end-users in terms of lower retail prices.*" It is easy to say that reduced input costs may lead to lower retail charges. We are concerned that Commission has taken a very simplistic view when making this statement. As is evident from analysis of call termination issues by national regulators there are complex distributional issues to be considered. Certain categories of customers will benefit from reductions in MTR, for example some fixed consumers, but other categories, the majority of mobile consumers, will be expected to face higher costs. This

³ Draft Recommendation, recital (3)

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could manifest itself directly through increases in retail charges or indirectly through an erosion of the competitive dynamic over time as the recommended approach is such a significant methodological shift.

The Commission's position on symmetry, as with many other aspects of the draft Recommendation, does not appear to be based on any robust analysis. The Commission proposes that all Member States shall have achieved symmetrical rates by a common date.

Asymmetric mobile termination rates have been a feature of national regulatory landscapes for a number of years. It is the Commission's stated view that asymmetry requires an adequate justification. Meteor believes there are a number of exogenous factors (largely arising from regulatory decisions), including date of market entry, that may justify asymmetric mobile termination rates for newer entrants relative to the early entrants in the market. We would acknowledge that symmetry in mobile termination rates should be achieved over time as the impact of exogenous factors, including time of market entry are eroded. Meteor strongly believes that date of market entry can justify an asymmetry for a transitory period. A newer entrant does not benefit from comparable economies of scale and so-called 'efficiency' relative to the established players as it has fewer customers and hence lower network utilisation. This means that the average per unit network cost of a newer entrant will be higher than the earlier entrants and the so-called 'efficient' operator.

Meteor does not agree with the Commission's proposed definition of an 'efficient' operator. The use of the term 'efficient' operator is emotive particularly as mobile network operators in Ireland are exposed to intense competition and there is no room for inefficiency. We do not agree that the estimation of an 'efficient' operator's per unit network cost should be based on network utilisation assuming $1/n$ (where n = the number of players in the market) share of the market. In a 4 player market the 'efficient' operator share will be 25% on this basis. To suggest that a newer entrant is inefficient because it has a lower market share than 25% and that an earlier entrant (e.g. with a market share in excess of 40%) is super efficient is simply incorrect. The fact that an earlier entrant with a high market share has a higher network utilisation and hence lower per unit network cost, is a direct product of the first mover advantage conferred upon it by the timing of market entry and the subsequent sequencing of additional market entry determined by the determined by ex-ante regulation. In addition, larger operators are also able to exert a higher degree of buyer power when dealing with suppliers of network equipment relative to newer entrants. Thus, where national regulators take decisions to encourage market entry at the network level there is justification for a period of asymmetry. The duration of this transition period is ultimately dependant on specific national factors.

However the Commission considers that it may be inappropriate to "reward" an operator for its smaller size. Indeed the Commission sees fit to state that "*the fact that many fixed and mobile markets in the EU have been liberalised for some time now raises a question as to the efficiency of the operators in question if they can still not survive in the market without some form of entry assistance.*"⁴ This may be a valid question to raise but it would be wholly inappropriate to base any policy decisions on such a supposition in the absence of any analysis.

In any event it is not a question of 'rewarding' an operator for its smaller size. The issue is one of equitable cost recovery. If the Commission's definition of an efficient operator is applied in practice it has the opposite effect, rewarding larger operators for their size. This would be wrong. Meteor is acutely aware that mobile operators, typically first and second market entrants, such as the Vodafone Group, are actively lobbying on the issue of rapid

⁴ Explanatory Note, page 16

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symmetry. We ask the Commission to pause and reflect on the motives of such operators. What is it they hope to achieve? First and second entrants are able to command a higher margin on their retail prices. Their margins have declined in recent years due to the competitive challenge from newer entrants however they still remain high relative to those of Meteor. That is the nature of competition. They know that smaller operators will be disproportionately impacted by rapid reductions in MTR and hope that regulation will weaken the competitive threat presented by newer entrants. If their expectations are met then those operators arguing for rapid symmetry will benefit to a certain extent from reduced interconnect costs for calls to newer entrants, but fundamentally they will be able to reinforce their ability to maintain higher retail margins which is ultimately to the detriment of consumers.

In an environment of agreed glide path reductions in termination charges such as that which exists in Ireland and many other EU members states, there is no validity in the suggestion that entry assistance in the form of higher termination rates might act as a disincentive to grow market share. Here, entry assistance is not enduring and the later entrants benefiting from entry assistance will logically exploit this short term advantage in order to gain market share and achieve the necessary scale economies that will allow them to compete once the asymmetry in termination rates has been removed.

What is at issue here is not the eventual move towards symmetrical MTRs but the timing of such a move and the end point for symmetrical MTRs, given the fact that mobile operators have already established medium term business plans based on MTR glide paths that have been justified to and agreed upon with the national regulator. Transient asymmetry can be objectively justified in light of exogenous cost factors the most significant of which are differences in spectrum licence holdings and time of market entry.

Meteor believes that national factors should be taken into account to evaluate the length of the transition period. The market entry date for mobile network operators is fundamentally determined by the award of spectrum licences by national regulators. Spectrum licensing and mobile market entry has tended to happen on a sequential basis and according to a similar pattern, albeit with different timings, within Member States. The first mobile operators entered national markets in the mid 1980's with analogue mobile services and commenced provision of 2G (GSM) digital mobile services in the early 1990's typically with two players in the market establishing de facto duopolies. Recognising that competitive circumstances in national mobile markets were far from satisfactory under duopoly conditions national regulators decided to allocate further spectrum licences to invite one (and in some countries two) additional entrants into the market during the mid to late 1990's. Additional market entry was encouraged through the 3G licence award processes in the early 2000's.

It is notable that while the spectrum licensing process in Ireland has followed this general pattern issues with the award process have resulted in Meteor being one of the last 2G operators to enter a national mobile market within Europe. In line with other Member States ComReg undertook to award the third mobile licence in Ireland during the late 1990's in order to stimulate competition. Meteor was awarded a GSM spectrum licence in June 1998 being the highest ranked in the comparative selection competition for the licence. However the award process was subject to a legal challenge and consequently Meteor's market entry was delayed until February 2001. During the intervening period penetration in the Irish mobile market rose from approx. 20% (June 1998) to 70% (March 2001). The delays arising from issues with the licence award process resulted in Meteor missing the rapid growth phase of the mobile market.

Meteor entered a mobile market dominated by a duopoly of Vodafone and O2 and initially struggled to gain traction in the market due to high switching barriers (mobile number

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portability was not introduced in Ireland until July 2003) and negative consumer perceptions regarding service coverage as our network was rolled out. Irrespective of actual usage patterns mobile consumers place high importance on perceptions of national coverage in their choice of mobile provider. During 2002 and 2003 we continued to roll-out our network coverage and in 2004 we secured a commercially negotiated national roaming agreement providing service coverage in the rural areas along the Western Seaboard of Ireland. The combination of reduced barriers to switching in an increasingly saturated market, the ability to offer full national coverage to prospective customers, and our value for money tariffing approach to the market improved our traction in the market. It was only during 2004 that Meteor was able to start competing effectively with the established players in contrast to other late entrant operators licensed during the latter half of the 1990s in other Member States.

Consequently it is entirely inappropriate to impose a common transition period for all European late entrant mobile operators or indeed a common period, referenced to market entry date, for later entrants within the national market. A range of factors should be considered including the date of entry, state of market maturity, fluidity of market (including timing of availability and efficiency of the MNP process).

6. Transition period

In the previous section Meteor set out its view that it is not appropriate to set a common deadline for the achievement of symmetry. We turn now to the transition deadline specified in the Recommendation which the Commission proposes to apply in respect of all aspects of the Recommendation.

Meteor is concerned that the date proposed by the Commission is totally arbitrary. As with most aspects of the draft Recommendation the Commission has failed to adequately justify its proposal. In respect of establishing a transition period the Commission's analysis is limited to the following⁵: *"Such a time period should, on the one hand, be long enough to allow regulators to put the cost model in place and for operators to adapt their business plans accordingly while, on the other hand, ensuring that consumers derive maximum benefits in terms of efficient cost-based termination rates. Such a period should be limited to 31.12.2011 as of which date the NRAs should ensure that the termination rates are set in accordance with this Recommendation."*

We would welcome visibility of the Commission's analysis as to why 31.12.2011 is an equitable balance of the relevant considerations. Mobile network investments are long term ventures and to suggest that operators can adjust to such radical changes in terms of the definition of allowable costs so rapidly is naïve.

We note that the draft Recommendation allows additional discretion to national regulator's to set rates based on an alternative method until 31.12.2013 in the event that they have not finalised the recommended cost model in a timely manner. However during the discretionary period the Commission proposes that rates set on an alternative basis must not exceed the average of termination rates set other national regulators using the recommended methodology. In essence the Commission is proposing the use of benchmarking in the event that an alternative approach justifies a higher termination charge than the average. Meteor disagrees with the arbitrary limitation proposed. Benchmarking is not the most reliable way to fix regulated prices. If it is to be deployed benchmarking should be based on the selection of appropriate comparators with necessary adjustments incorporated such as differences in purchasing power parity, national demographics (population density and

⁵ Explanatory Note, Section 7

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dispersion), etc. It is surprising that the Commission is proposing such an arbitrary form of benchmarking. We believe a more considered approach is required.

7. Choice of costing methodology

The draft Recommendation advocates the use of a bottom-up modelling approach. This is despite the fact that the Commission itself recognises⁶ that “*top-down models are said to avoid disincentives to invest*” and “*bottom-up models may understate the costs*”. It is generally accepted that a hybrid approach generates more reliable results. The draft Recommendation fails to place sufficient emphasis on the need to validate bottom-up cost modelling through comparisons with a top-down model. In theory, competitive market conditions will ensure that operators compete on the basis of current costs however the practice of validating bottom-up cost models with top-down cost models recognises the fact investment cycles will never be so short as to ensure that operators can deploy the most efficient modern technology as soon as it becomes available and that all operators will be subject to legacy costs to some degree. In the current draft the decision to construct a top-down model is left to the discretion of NRAs. Meteor believes that this should be a mandatory requirement.

⁶ Explanatory Note, Section 4.1