ECTA Comments on ERG Public Consultation on a draft Common Position on Symmetry of Mobile/Fixed Call Termination Rates January 2008

Summary[1]

- ECTA considers that in addressing early/late entrant asymmetries as a priority, the ERG has overlooked the main priority for consumers and fixed and late entrant mobile telecoms competitors – which is the **absolute level of mobile termination rates**, and the distortions in mobile competition and competition between fixed and mobile operators caused by **on-net off-net discrimination** (in excess of cost-based differences) by operators with substantially larger customer bases than their competitors
- In addition to termination, the ERG should also examine **excessive pricing by operators with a large customer base of call origination services** (for example to directory enquiry numbers) due to the high bargaining power of such operators and their interests in favouring their own-provided services. The link between real mobile termination costs and the costs of wholesale roaming should also be considered.
- The document appears to be **aiming towards 'symmetry' between early and late entrants as opposed to objectively cost-oriented rates** that do not discriminate amongst operators or between fixed and mobile technologies. Inappropriate symmetry (where this does not permit cost recovery for entrants) would disincentivise investment and could result in consolidation before operators are able to reach efficient scale.
- The **treatment of asymmetry for small mobile operators seems to be more favourable than that suggested for fixed entrants** despite the fact that the degree of sunk costs in the fixed environment are considerably higher whilst achieving scale can often take longer than in the mobile sector. There should be equally sensitive treatment of small mobile and fixed entrants.
- Timing of convergence between fixed and mobile rates depends on the objective cost of termination to an established mobile operator assessed on the same basis as fixed (ie excluding marketing and access costs). Equal pricing of F2F and F2M rates by an integrated operator and **fixed mobile number portability should be dependent on termination pricing convergence being achieved and on equal opportunity for provision of converged services** (quality of spectrum, availability of MVNO on commercial or otherwise regulated terms)**.**
- **Asymmetries for both fixed and smaller mobile operators may be justified** in terms of economies of scale, costs associated with late entry into mature markets (high acquisition costs and market fluidity), differences in access to capital and risk profiles and importantly by the **extent to which regulation provides a level playing field with incumbent/early entrants**.
- Entrants are likely already to be using efficient technologies and architectures (subject to the constraints of the need to interconnect), but lack scale and are often prevented from gaining scale through factors outside their control**. Efficiency cannot be assessed in isolation from regulatory factors affecting the playing field**.
- ECTA favours **assessment of costs on a national level based on harmonised EU principles and methodologies**. A **standardised 'entrant' rate or mark-up**[2] could be calculated whilst permitting operators to demonstrate if costs exceed this rate.
- ECTA supports a **glide-path to symmetry, subject to modification if exogenous factors (including the regulatory environment) undermine the assumptions** that would justify equal treatment.

[1] This position paper represents the views of a majority of ECTAs members. However, certain members – in particular those with incumbent interests – cannot be presumed to agree with all aspects
[2] The setting of such standardised asymmetric rate is aimed at providing a benchmark for rates agreed with dominant incumbents or early mobile entrants, but should not prevent entrants from agreeing lower symmetric rates with the dominant provider. When negotiations occur between entrants, there is an assumption that symmetric rates will be reached on the basis of the default entrant rate identified by the regulator. Where different termination rates are charged depending on the interconnection partner this should be reflected in rates charged by the transit service provider, often the incumbent.

<u>Preliminary remarks</u>

The consultation does not address the main regulatory concern relating to termination – high and discriminatory mobile termination rates

ECTA has serious concerns that in solely addressing differences between incumbent and entrant termination rates, the ERG consultation is focusing on a secondary issue rather than the main priority concerning termination rates, which we consider to be the high level (in absolute terms) of mobile termination rates and discrimination in rates charged internally vs externally which has resulted in competitive distortions.

ECTA suspects that the regulatory regime has permitted excessive MTR rates because the underlying costs (particularly for established mobile operators) of regulated mobile termination have been inflated of through inclusion of certain cost elements which are no longer justifiable for large-scale players in a mature market. These high costs have been directly passed to consumers in higher charges for fixed to mobile calls and off-net mobile to mobile calls.

In addition, such operators have further compounded this advantage through charging very different rates for the same service (when provided to themselves as compared to third parties including fixed and smaller mobile competitors) and foreclosed entry and growth in the mobile market as well as distorting competition between fixed and mobile operators.

The high absolute level of MTRs in Europe is evidenced for example by:

- The high multiple of mobile to fixed rates in Europe compared with other regions[3]
- Significant differentiation between fixed to mobile and mobile to fixed retail prices and between mobile termination rates charged to third parties as compared with 'on-net' fixed to mobile retail charges levied by some mobile operators
- Comparisons with receiving party pays environments in which the costs for call termination are substantially lower

ECTA notes that some discussion is made of discriminatory pricing (on-net off-net differentiation), but in relation to mobile competition only. As described below – the effect extends to fixed competition and fixed mobile convergence. Furthermore the ERG consultation does not propose concrete solutions to this specific problem

ECTA believes that both the absolute rate for MTRs and the competitive distortions could be addressed through properly enforcing the wholesale remedy of non-discrimination which requires dominant operators to provide services to third parties on equivalent terms and conditions to those which they supply internally. The non-discrimination obligation was automatic for SMP operators under the previous framework, and has been selected as a remedy by NRAs for most of the clearly dominant operators under the new framework, but it has largely been left unenforced.

The consultation does not address the relationship between call termination and call origination pricing

In addition to the termination bottleneck, operators with a substantial portion of the customer base also have control over a large part of the service market, and may as a result be able to exercise negotiating power over providers of services (such as Directory Enquiry providers) that need access to this customer base to reach critical mass. Whilst call origination is technically similar (and therefore should be similar in cost terms) to call termination, an operator with a large customer base may, in the absence of regulation, offer high and discriminatory rates raising the

[3] See enclosed, previously submitted letter

cost of accessing competitors' services above the nominal cost of origination (roughly equal to termination) and the cost of the service provided.[4]

International roaming is another area where the cost of wholesale access should in theory be similar to the termination rate. However, as there is no legal link between this rate and the regulated termination rate in the Roaming Regulation, large mobile operators with extensive coverage and bargaining power in roaming agreements could fail to pass on lower 'real' costs.

General questions

QUESTION G1: Do you think that the principles outlined in the general economic introduction cover adequately the underlying economic situation of both mobile and fixed termination markets?

The consultation seeks to justify a uniform outcome (symmetry between incumbents and entrants) rather than consistent application of the rules (cost-orientation including a fair return)

We note that in examining differences between incumbent and entrant termination rates, the ERG consultation appears to focus on a result that is deemed desirable (symmetry) rather than applying principles of non-discrimination and objective cost-orientation and incentivising investment in a consistent and non-discriminatory way.

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 a 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 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 termination rates symmetry is a possibility but only in the case in which 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
- Differences in the competitive landscape taking account historic advantages (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))

Case for dynamic efficiency outweighs static efficiency during periods of entry and expansion

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 termination services. Nevertheless, it is important to highlight that the concept of efficiency needs to be evaluated in the light of the

[4] See enclosed previously submitted letter

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.

ECTA therefore strongly disagrees that *"symmetric TRs contribute to enhance static economic efficiency (limiting allocative and productive efficiencies), investment and innovation and finally global welfare…[5]"* – at least during the entry and expansion phase in telecoms markets. This statement does not adequately reflect the peculiarities of the communications industry, which is characterized by high level of sunk costs and therefore significant impact of economies of scale and historic advantages. Operators entering mature markets with established operators must, in nearly all cases, and irrespective of superior quality of service, do so by pricing retail services far below the incumbent operators, and are therefore faced with high capital expenditures, limited revenue streams and fierce competition (especially from incumbent operators).

The second statement that *"asymmetric TRs, by encouraging entry, contribute to dynamic efficiency and favour competition"* seems to be more appropriate to the characteristics of the communications market and the objective of the liberalization process which was to eliminate monopolies and therefore encourage market entry by new operators. This obviously does not mean that asymmetries need to be maintained indefinitely since it is correct that they are either phased out or progressively reduced in the long term but this cannot simply imply imposing symmetric termination rates on all operators. Instead, NRAs should work on applying all necessary measures to allow full and effective competition on the markets, by removing existing bottlenecks and discriminatory and abusive practices by incumbents and allowing operators to invest, grow and achieve market share, which will inevitably lead to lower unitary prices with the added benefit of greater competition on the market.

Adequate (i.e. reflecting objective costs) termination rates give rise to an automatic "**virtuous cycle":** while providing the operator with the means of extending coverage to new areas and increasing the clients' base, they enable the achievement of economies of scale and ultimately to the lowering of costs and tariffs. Such a chain of adequate return > network development > scale economies > lower costs cannot be ignored or prevented through short-sighted measures, ignoring the degree of development and liberalization currently achieved in each market.

Presumption of symmetry reinforces existing advantages for early entrants and incumbents

Incumbent operators of fixed networks and early entrant mobile 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 duopoly regime for mobile networks and post-liberalization via high interconnection charges that have allowed them to fully recover their costs.

Incumbents' current termination rates thus represent the cost of an operator with a very high penetration rates and very high market share and call volumes and which has completed the network roll-out. Assuming this 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.

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

It is important to note that while it is true that in most 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

[5] Page 7 of ERG consultation document

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 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).

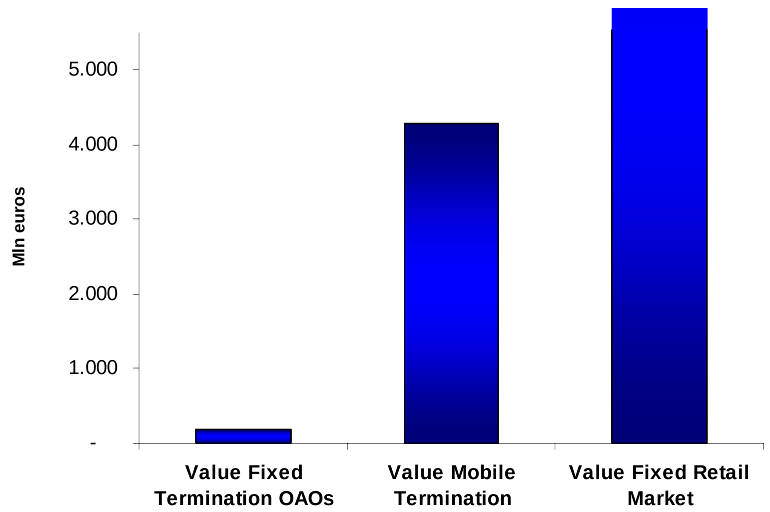
Inappropriate symmetry disincentivises competitive investment

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 (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 buying wholesale services from the incumbent.

Impact on consumers of asymmetry for small operators is limited

With regard to the translation in higher retail prices for calling the alternative networks, the focus should not be on the nominal values of the 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 termination rates on the retail market is limited if not negligible.

The figure below relative 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 termination rates, invest and achieve market shares, it is inevitable that termination rates will decrease and so will the impact on the market whilst the presence of infrastructure based competition will bring benefits to consumers in the longer run.

QUESTION G2: Any further comments regarding consistent regulation of both MTR and FTR with regard to symmetry is welcome

The consultation continues to discriminate between fixed and mobile

The EU Regulatory Framework is first and foremost based on the objective of promotion of competition. This should be achieved by applying similar rules to similar cases in a non-discriminatory manner. This suggests that cost accounting criteria and methodologies being developed by NRAs should: (i) allow for consistency with regulatory approaches adopted in relation to other operators in the market (i.e. the incumbent operator and the mobile operators) and in a non discriminatory and technologically neutral manner and at the same time, (ii) take into account the characteristics of the new operator's networks and technologies.

ECTA notes that the approaches to termination regulation of fixed and mobile operators has differed in several important respects, including:

- Treatment of access network and marketing costs in calculating termination rates, resulting in higher termination rates for many years for incumbent operators are early entrant mobile network operators.

- Endorsement (many years after market entry of the operators in question, and in fact often after 2003) of substantial asymmetries in favour smaller operators – resulting in operators with market shares of <10% having an average termination rate 47% higher than the lowest rate, whilst those with 10-20% have a rate 13% higher.

Whilst this approach has undoubtedly contributed to the development of the mobile market, it has created substantial distortions between the fixed and mobile markets, which has given integrated incumbents and the largest mobile operators an undue advantage in the developing fixed mobile converged space. ECTA is concerned to find that the ERG's consultation suggests different (more sympathetic) treatment for late entrant mobile operators compared with equally late fixed entrants, whilst at the same time the methodological differences which result in mobile termination rates being set higher than fixed termination rates in absolute terms and which result in a subsidy from fixed to mobile operators have not been addressed.

Access and marketing costs should be transitional to aid fixed and mobile entry but are not warranted for mature players with extensive networks and customer bases

The consultation mentions, without elaboration, that NRAs in most Member States, when setting mobile termination rates, have permitted the inclusion of commercial and marketing costs, cost of terminal equipment and in general benefits from "network externalities" for the purpose of promoting investments in the construction and development of infrastructures and client base. These costs have not however been allowed for investors in fixed infrastructure, probably because costs were traditionally modelled on incumbents which fully recovered the costs of their access networks, which continue to provide an enduring advantage.

As mobile operators are increasingly competing in the fixed market via integrated offers this differential treatment distorts fixed/mobile investment decisions and leads to an unfair disadvantage for fixed network operators that are not vertically integrated with mobile operators (nearly all incumbent operators have a mobile business, and in nearly all cases this mobile business is either the largest or second largest early entrant mobile network operator). Among the possible solutions described by the ERG consultation document are:

1. Taking account of the access network costs when calculating FTR
2. Not including them in the MTRs

ECTA agrees that consistent treatment is urgently needed. However, ECTA sees a third possibility that would reflect the original and laudable intentions behind this approach (as a mechanism of financing greenfield investments in networks for newer operators) whilst not extending the model in perpetuity.

Marketing and access investment costs could be considered for both fixed and mobile entrants as a temporary transitional aspect (entry-related costs) to be reduced through the price cap mechanism, ultimately to zero. It is certainly unlikely that the inclusion of such costs would be justifiable for an operator with an established network and customer base.

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

Whilst not addressed in the main body of the consultation, 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 (as is recognised by the ERG), but on fixed/mobile competition and consumers.

1. Consumers and business users (inside or outside the terminating country) pay comparatively higher retail call tariffs - for all fixed to mobile calls and most off-net mobile calls. This has neutralised some of the substantial benefits that should have been delivered through competition as fixed and late entrant mobile operators have been prevented from offered lower retail prices for these calls.

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

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

   - 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 mobile numbers), 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 as well as other calls.

Clearly ECTA would not wish for consumers and business users to be deprived of innovative services or to undermine the development of fixed mobile convergence and – ultimately – number portability between fixed and mobile numbers. Our aim is rather 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.

The on-net problem in mobile is also a risk for fixed[6]

In addition to regulatory action with regard to asymmetry of (mobile) termination, a strong signal should be sent to regulators and incumbents that this kind of discrimination 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 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 even 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 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 disagrees that this is a retail issue (which amounts to it not being addressed efficiently in most cases). Instead, there is a need, enabled by the regulatory framework, for NRAs to monitor retail behaviour and its consistency with wholesale prices and terms, e.g. by means of cross-checks whether wholesale obligations to supply cost-based termination on a non-discriminatory basis are being complied with.

Possible developments: bill and keep must be treated consistently

In the long term, the shift to bill and keep arrangements could be a positive development and a common goal, but this can only happen if all operators on the market, both fixed and mobile, were to move to this type of arrangement, due to the convergence trend and unfair advantage and discrimination issues which would arise once again in case it were applied for example only in the fixed market or amongst mobile operators but not as regards fixed to mobile interconnection.

QG3: Elaborate on the question of converging MTRs and FTRs and the timeframe you envisage for this

It is not possible to say definitively if and when MTRs and FTRs would converge without understanding the true costs of mobile termination for an established operator, calculated on the

[6] 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)

same basis as fixed termination (eg excluding marketing and access costs after a transitional entry period).

However, it is important that equivalent treatment (eg in terms of numbering, equivalent F2M retail charges as F2F) is only permitted if and when the rates converge.

Fixed part

QF1 How do you think termination should be regulated in a converging fixed-mobile market?

The following factors should be applied to setting termination rates in a converging market:

1. Rates should be set on a non-discriminatory and transparent manner. This should apply equally to fixed and mobile operators.
2. Temporary divergences from efficient cost-orientated rates should be justified and evidenced in a transparent manner
3. Cost accounting and accounting separation principles should be applied on a consistent manner to both mobile and fixed operators.
4. Arbitrage opportunities between fixed and mobile operators should be minimised
5. No pricing shocks to the market.

Critically, in order to ensure a fair level playing field for competition, consistency of retail pricing (eg between the prices charged by an integrated operator for on-net fixed to mobile and fixed to fixed calls and numbering (fixed mobile number portability) should depend on consistency (absolute convergence) between fixed and mobile termination rates and equal opportunities for market entry. In particular smaller mobile operators and fixed competitors should not be denied entry into the provision of converged fixed mobile services due to the characteristics of spectrum (less effective in-building coverage) or absence of commercially agreed or otherwise regulated MVNO access.

QF2 Do you agree on the methodology and assumptions underlying the asymmetry index calculation (p28)

ECTA notes the following in relation to the Asymmetry Index calculation which estimates the difference between the incumbent and an average of the various OAO for local call and single tandem termination rates:

- It is unclear whether the termination value for single tandem includes transit for such calls which was recently removed from the EU list of markets likely to be susceptible to ex-ante regulation.

- The manner in which the average price is calculated for the largest OAOs in a jurisdiction in the index. Is a simple average of the various OAOs taken, or is the operator with the largest differential rates from the incumbent operator chosen for the analysis?

- The ERG assumes in the global asymmetry index that the distribution between local and single tandem traffic is 50:50. This may over-estimate the proportion of single tandem traffic in a majority of Member States.

QF3: Do you think the list in para 7.1 (p35) constitutes an exhaustive list of the possible reasons justifying the adopting of asymmetric tariffs?

ECTA considers that asymmetric tariffs may be justified by any objective differences which cause the costs of operators to exceed others due to factors outside their control. ECTA also considers that historically accrued advantages (including those resulting from differential regulation) cannot be ignored.

In addition to the factors listed in the ERG consultation document, entrants in fixed markets face greater costs and risks due to their greater reliance on the effectiveness of administrative and economic regulation, for example in arranging rights of way (typically to enable the replication of infrastructure historically developed by incumbents, often with state aid) or accessing unbundled local loops to offer services to customers. Access to finance may also be more restricted for a subscale operator.

AGCOM has for example, recognised that: "*The incumbent operator has made the majority of its network investments in the course of time, in a monopoly regime, obtaining adequate remuneration. Alternative operators, on the other hand, find themselves investing in a liberalized market with a <u>greater market risk deriving from the presence of an operator with significant market power, with relevant difficulties to obtain authorizations from local authorities per civil works, minor economies of scale, greater difficulties in accessing capital markets</u>. This implies that, in the relevant markets open to competition, it is not possible to obtain adequate revenues so that to allow a fair remuneration of investment, on one side due to the competitive pressure and, on the other hand, for the possible anticompetitive behaviour of the incumbent operator, which could, for example, voluntarily reduce price margins to exclude its competitors. So, the only service that if fit to remunerate part of the new infrastructures is the termination service, that therefore, as a function of the investments effectively made, can reach different price levels for each operator."*

In addition, an entrant is likely to face costs associated with winning market share in a mature market and thus may face increased marketing costs compared with an operator with an inherited or well-established customer base in markets that were previously subject to rapid expansion. Entrants may also face other difficulties resulting from switching inefficiencies e.g. due to contract tie-ins from the dominant operator or ineffective number portability or synchronization of number portability.

The factors mentioned above have been reflected in discussion of asymmetry within mobile markets (page 82 of the consultation document). It is also clearly stated at page 83 in relation to mobile markets that 'the fact that an MNO entered the market later can justify an asymmetry for a transitory period'. Similar language should be adopted in relation to the fixed market.

QF4: Do you agree on the fact that any entry assistance policy for the future based on higher OAO FTRs is likely to be less effective than in the past?

ECTA disagrees with statements in the ERG consultation document that aim to justify symmetry through claiming that that higher asymmetries may be less effective in supporting entry

It is true that the proportion of revenues from calls is decreasing relative to other services, but it remains the highest component of telecoms sector revenues (as confirmed in the Commission's 12th implementation report) and is a substantial source of advantage for incumbents, which continue to be able to use cash-flows from voice services, usually provided via fully depreciated networks, to comfortably fund all broadband/next generation network/access investment internally, whilst still achieving a substantial return for shareholders.

Moreover, the fact that many competitors are offering a range of services does not remove the need to recover costs across the various services, through effective cost allocation methodologies. Nor does it alter the need for all operators to be given the same opportunities to recover the specific costs of each service and eliminate the issue of economies of scale relative to voice termination.

It should also be noted that the use of multi-play by competitors has often been prompted by the fact that they are unable to recover the costs of inputs such as ULL from offering voice alone. Were pricing anomalies addressed between retail line rental and ULL, it is possible that competitors would be able to address more of those customers that wish to take telephone services without other aspects of the bundle.

QF5: Could you provide a definition of the 'efficient operator' NRAs should refer to in fixing FTRs? What are the costs an efficient operator would incur to provide termination services?

The meaning of an 'efficient operator' in technical terms will be a continuing moving target as the industry is dynamic and new technologies emerge. Typically the network architecture and technologies adopted by an entrant might be considered efficient. However as a late entrant in a mature market they are likely to face greater acquisition costs and lower scale economies as well as being disadvantaged through any deficiencies in the regulatory environment. They may also face costs such as those relating to rights of way that may not have been incurred by the incumbent.

In terms of efficient scale, a balance would need to be struck between the economies of scale achieved by a monopoly and those achieved in a less efficient environment (in terms of scale economies) but which benefits from the dynamics of competition.

Accounting methodology needs to be adapted to changing architecture and technologies of NGN networks

Regulatory accounting methodology in the fixed sector has up to now been based on traditional incumbents' PSTN network infrastructures. NGN/NGA architectures will cause the need to review traditional accounting criteria.

A fundamental characteristic of NGN/NGA networks is the de-centralization of network functions to peripheral network elements, including at the customer premises. These network elements perform functionalities (such as signaling) which in traditional networks are performed at the local exchange level, and therefore the allocation of these costs to the termination service should be based on the logical functionalities regardless of where they are located.

These network elements (called CPE or HAG) perform relevant functions of the former local switches and also many functions linked to a performing implementation of NGN. In this context, accounting criteria need to be adapted to new network architecture where the traditional distinction between access (from MDF to customer site) and core network (shared infrastructure) no longer applies.

Excluding these network elements from termination services would on one hand imply a discrimination vs incumbents since the latter include for example signalling costs in termination charges and on the other would have the perverse effect of adapting to the NGN networks- which today represent the goal and reference model- the logic of traditional networks which are being phased out.

QF6: Do you agree that OAOs should be as efficient as the incumbent?

In general, non incumbent operators, especially in the fixed market, cannot afford not to be efficient given the need to compete with a well established operator who has completed its network roll-out many years ago and has close to 100% penetration of the population. Incumbent operators thus enjoy significant revenue streams coming from existing retail customers and wholesale revenues from sales to other operators, completely funded networks (in many cased inherited from monopoly positions and supported by that state in the monopoly period), EBITDA margins close to 50% and significant profits. The can afford a certain degree inefficiencies, but the same is not true for other operators who need to finance their investments on the capital markets, are in the stage of deploying their network, acquiring customer base and competing on price and quality with incumbent operators which in many cases also control a significant portion of their costs and levels of quality via wholesale services.

These factors must thus necessarily be taken into account when considering the issue of symmetry of termination rates and duration of a glide path and enforcing the concept of efficiency. ECTA agrees that NRAs should adopt measures to ensure all operators' efficiency but these measures need to tackle the real inefficiencies and not deter new entrants from investing or depriving operators from the ability to recover the reasonable costs and achieving a return on investment consistent with the risks they are taking in bringing competition to the market.

Relatively higher termination rates in the initial phase do not imply inefficiency on the side of the entrant operator requesting them, but:

(i) are currently justified by <u>lower economies of scale</u>, higher impact of <u>sunk costs</u> and <u>different topology</u> of the network;

(ii) are necessary to <u>develop the network</u> in the most efficient and effective manner:

QF7: Do you agree on the fact that there are less reasons for fixed operators compared to mobile operators to justify the adoption of asymmetric tariffs?

ECTA strongly disagrees with the statement in the consultation that *"it is unclear whether and, if so, to what extent OAOs would suffer from diseconomies of scale relative to the incumbent. Unlike in the mobile sector where generally all operators are subject to coverage obligations and have to adopt a specific technology, fixed OAOs are free to enter in selected areas – i.e. the ones that are potentially the most profitable – and adopt whichever technology they believe is the most efficient. In this regard, a fixed OAO operating on a regional basis, using a new technology and an optimized network will presumably be able to reach an efficient scale in a relatively short timeframe. Therefore, the claim that OAOs suffer from dis-economies of scale may not be as strong as sometimes thought. Furthermore, the claim that there are endogenous factors that lead to them having higher costs- an argument valid for setting asymmetric MTRs in the face of different and not modifiable spectrum endowments- may therefore not be justifiable*".

This statement seems to ignore the characteristics telecommunications networks in which there is, even on a regional basis, a high level of sunk costs before being able to offer the service to a single customer and therefore the issue of economies of scale still persists. Even in the hypothetical case in which this were true, then it would imply that NRAs would favour through regulatory decisions the creation of regional operators with a limited scope thus benefiting in any case the incumbent who would be the only one with a national scope without the presence of serious competition at national level.

The same can be said about the statement in the consultation document according to which OAOs would not have diseconomies of scale due to the absence of coverage obligation or the choice of technology. Again, if the objective of NRAs is the creation on the fixed market merely of a resale-based competition this can be true but in case of infrastructure-based competition model, OAOs need to have a national scale in order to effectively compete with the incumbent and therefore there need to be appropriate incentives to increase network build-out and increase of market shares.

The comparison with mobile operators is misplaced since it is true that there were coverage obligations contained in the mobile licences but this was counteracted by the fact that mobile operators were able to recover a substantial proportion of access costs and even marketing and terminal equipment costs via termination rates – including termination payments from fixed operators.

A more relevant indication of the degree to which economies of scale are pervasive in the fixed sector can be found in the JP Morgan Fibre Battle study that found that 'an (almost) nationwide fibre network may be 10 times more expensive than a second mobile network'.

Additionally, whilst due to the technological design, wireless networks may be expanded and dimensioned to cater for an initially low level of traffic, and densified thereafter, fixed infrastructure (such as fibre lines) incur a high fixed cost which is less traffic dependent and therefore results in greater scale economies. We note with interest that according to figure 18, the Romanian regulator has calculated that unit costs in the mobile sector reach parity with market shares of around 33%, and wonder what a similar calculation for the fixed sector would show.

Indeed differences in cost structures between fixed and mobile networks, fixed voice market maturity, and permitted mechanisms for recovering costs have translated to market outcomes in which even relatively large fixed operators typically, and after comparable periods of time, have far lower market shares than mobile operators in the access and voice markets.

QF8: Do you agree on the fact that if all call termination charges were based strictly on incurred costs there would be a distortion of competition?

We agree that termination rates should be based on 'efficiently' incurred costs and not all incurred costs. However, the fact that an entrant's costs could be higher than an established operator does not necessarily mean that they are inefficient or that setting asymmetric termination rates would distort competition.

With regard to the ERG's suggestion that operators would have the incentive to set high call termination charges which raise competitors costs and create a distortion of competition, this argumentation applies to all operators and is one of the reasons why termination is considered a 'single operator' market. It is precisely to address this that wholesale charges are regulated. The perverse incentive described in the ERG consultation could be addressed through sensitive, but effective controls on pricing levels to ensure that they are not priced inefficiently whilst nonetheless allowing for a fair return.

QF9: Do you agree on the fact that symmetric tariffs would allow to avoid transaction and regulatory costs?

At a simplistic level, refraining from making the effort to calculate accurately the cost of each operator is more straightforward and would result in fewer transaction costs for the regulator. The same is true of using benchmarks rather than a full cost analysis. However, the costs of setting an inappropriate rate which does not allow recovery and thereby deters competitive entry and expansion are far more significant and has far-reaching consequences on investors' confidence to invest in the telecommunications sector going forward.

Transactional costs by the regulator could be limited through setting a single entrant rate based on models, whilst placing the onus on operators in the market to demonstrate if their efficiently incurred costs are justifiably higher than that benchmark rate.

It is also noteworthy that alleged transaction costs have not prevented most NRAs from adopting asymmetric models in the mobile sector.

QF10: Do you agree on the fact that NRAs should reach symmetry in FTRs within a reasonable period of time?

ECTA agrees that symmetry should ultimately be achieved on the basis that the advantages between an established operator and entrant should diminish over time. However, the period of time to achieve symmetry should objectively reflect the time taken by an efficient entrant to become fully established in the markets relevant to FTR cost recovery which include the retail calls market (a mature market will little scope for expansion) and the access market (a market involving very high sunk costs and economies of scale).

Evidence in fixed markets in particular suggests that it can take substantial periods of time for even a strong entrant to match the incumbent's position in these markets.

Furthermore the ability of entrants to reach critical mass is based on the extent to which economic and administrative regulation provide a level playing field compared to the dominant operator and/or early entrant large mobile operators. In an environment for example in which rights of way, number portability and unbundling have been inadequately addressed or in which the incumbent and/or large mobile operators are able to discriminate to limit the expansion of competitors, the 'reasonable' period for reaching symmetry would probably be extensive.

We note that the factors mentioned above have been reflected in the section on mobile operators at page 82, where permissible factors include:

- The date of entry (NB in fixed markets, the entry date for all entrants is very late compared with the incumbent)
- Market maturity (NB in fixed markets call markets are mature and now declining)
- Market fluidity (e.g. caused by high switching costs e.g. through non-effective number portability, contractual tie-ins. Network effects and on-net pricing are also mentioned)
- Level of competition (number of players) in the market. NB fixed markets typically have more players than mobile

These factors should also be reflected when considering fixed markets.

QF11: Do you agree that it would be reasonable for NRAs to allow a transition period to move to symmetric FTRs? How long should this transition period be?

A transition period is essential to allow time for entrants to gain the critical mass that warrants symmetric rates. The period for the transition will depend on the current market situation (market maturity, current market shares) and could also be affected by exogenous factors (see answer to question 13) that affect the ability for an entrant to compete with the dominant operator.

QF12: In your opinion what criterion should NRAs adopt to set the glide path?

The glide path should be set based on a model reflecting objective expectations of costs, market share and revenues and after examining market fluidities – which may be influenced by the effectiveness of regulation. The price control could be set in relation to inflation with an additional criterion to reflect exogenous factors (see answer to Q13).

QF13: As the length of the glide path is a controversial point, should the time period to reach symmetry be the same for all NRAs or should each NRA determine according to national circumstances?

Each regulator should determine the glide path according to national circumstances based on reasonable projections of the initial status of competition and market developments. For example a late entrant in a recently liberalized market or in a market which is characterized by a strong incumbent/protected entrant position is likely to require more time to reach critical mass. We note also that this option is considered preferable for mobile markets in cases where the NRA uses a bottom-up cost model.

There are also factors outside an operators' control that may affect its ability to expand, such as practical difficulties over rights of way or access to key regulated inputs such as local loop unbundling or abusive practices by the dominant operator. Governments and regulators must act to minimize the effect of such problems, but in the event that they persist and where they result in an uneven playing field as compared with dominant players, competitors should be permitted to apply to vary the price control to reflect these exogenous factors.

Mobile part

QUESTION M1: Do you agree with the general principle promoting symmetry: "Termination rates should normally be symmetric"?

ECTA agrees with this statement but only on the basis that 'normally' means in circumstances where there are no distinctions between the opportunities available to all market players. This is not the case in practice in mobile markets because in a market with absolute barriers to entry, some have entered earlier, during a period of market growth and have benefited from protected regimes or high interconnection charges. Those not benefiting from such advantages may legitimately face higher unit costs for as long as they are disadvantaged by virtue of factors outside their control.

QUESTION M2: Do you agree with the exception to take into account exogenous cost differences: "asymmetry is only acceptable to take into account exogenous factors, outside the *control of operators*"? The only example, which is not related to a late entrance, identified by ERG is cost differences due to the spectrum licensing holdings. Can you identify other exogenous factors?

ECTA agrees to the need to take into account spectrum asymmetries as an exogenous factor but in this respect notes that also that there are other competitive issues arising from late entry into mature market including where early entrants have been able to benefit from excessive MTRs.

QUESTION M3: Do you agree with the following principle: *"Assuming that cost differences due to different spectrum allocation are properly evaluated, they may justify an asymmetry"?*

ECTA invites ERG to give guidance on the appropriate mark up which should be granted for any Mhz of imbalance in spectrum allocation. The formula should use as parameters:

- Number of Mhz assigned to each operator in each band.
- Percentage of population living in densely populated areas (main driver for relevance of differences in 900 and 1800 Mhz spectrum allocation between operators)
- Percentage of mark up for any difference in spectrum allocation in densely populated areas.
- Percentage of mark up for any difference in spectrum allocation in scarcely populated areas.
- Percentage of mark up for any difference in spectrum allocation in the 900 Mhz band in densely populated areas.

QUESTION M4: Do you agree with the following principle: "*If the level of competition in the mobile retail market asks for measures which create incentives for new network level entry or measures that strengthen the position of small new entrants, substantial differences in the date of market entry can justify an asymmetry for a transitory period"* ?

ECTA agrees with the principle as outlined in the CP and invites ERG to clearly state that late entrance is without any doubt an exogenous factor outside the control of the operators.

QUESTION M5: Do you agree with the principle of keeping the level of asymmetry "*reasonable*"?

ECTA agrees that asymmetry between operators should be kept within a "reasonable" extent where "reasonable" refers to the existence of adequate cost justifications for any differences.

One idea might be either for the ERG or for national regulators, with assistance from a cost model, to identify a benchmark (perhaps as % of the cost set for early entrants) whilst requiring any amounts exceeding this to be individually justified.

QUESTION M6: Do you agree with the fact that an initial level should be accompanied by a glide path towards symmetry?

There are a number of factors that may affect cost differences. ECTA agrees that a glide-path to symmetry should be set in relation to costs that are within the operators' control. However, for other exogenous factors such as spectrum allocation and behaviours by competitors that may undermine market expansion (such as on-net off-net strategies by large players) such asymmetries could not be removed until the exogenous factors are addressed.

QUESTION M7: Do you agree with the fact that national factors should be taken into account to evaluate the length of the transition period?

Nationally specific factors should be taken into account, perhaps subject to a harmonised Framework for assessment that ensures that regulators treat in a similar way issues such as:

1. Number of years of late entry.
2. Market penetration when entered in the market.
3. Average churn rate in the market.

QUESTION M8: Do you agree that in specific market circumstances (MTRs tariffs are significantly above MTR costs, there are high traffic imbalances between mobile operators and benefits of a transitory asymmetry outweigh any short term disadvantages of doing so), a temporary asymmetry may limit competitive distortions?

ECTA agrees with the general principle. However, the broader implications from MTRs not being at real cost go beyond just the fact that traffic imbalance is already present in the market. Imbalances and hence extra margins for incumbents (if MTR are not at real costs) occur every time a new entrant operator chooses to adopt an aggressive commercial strategy.

QUESTION M9: Do you agree that NRAs should first try to set MTRs at costs?

ECTA strongly agrees that a high priority should be given to ensuring that MTR are cost-based (allowing for truly objective differences which may result from later entry). ECTA believes that larger mobile operators have gained from excessive MTRs far beyond the period where there might have been cost justification for higher rates.

In addition, action should be taken to address behaviour which limits competitive expansion such as on-net discrimination by operators with a large customer base. Strict enforcement of the non-discrimination condition for internal/external supply of termination for such operators could be one possible solution.