Fastweb Contribution to ERG Public Consultation on a draft Common Position on symmetry of mobile/fixed call termination rates

1. FIXED CALL TERMINATION

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?

- If yes, do you think they are sufficiently reflected in the two parts on "MTR symmetry" and "FTR symmetry" and that they are consistently applying the principles?
- If no, what do you think is missing and which reasoning should be added?

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

1.1. General Comments and answers to G1 and G2;

The fundamental principles contained in the European 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 allowed to recover their costs in order to promote a fair and sustainable competition. Furthermore, the principle of technological neutrality seems to imply that regulators cannot favour specific operators and technologies by allowing some operators to fully recover their costs, while 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 symmetric termination rates should be admitted only in the case in which there is an effective equivalence of circumstances and, in particular, it may be justified by an alignment of underlying costs. The circumstances that need to be considered are in particular:

- Time of entry
- Market situation (e.g. incumbent's market shares)
- Technological differences
- Barriers to entry (such as economies of scale and sunk costs)
- Levels of investment required;
- Network architecture (both the one needed to operate and the incumbent's).

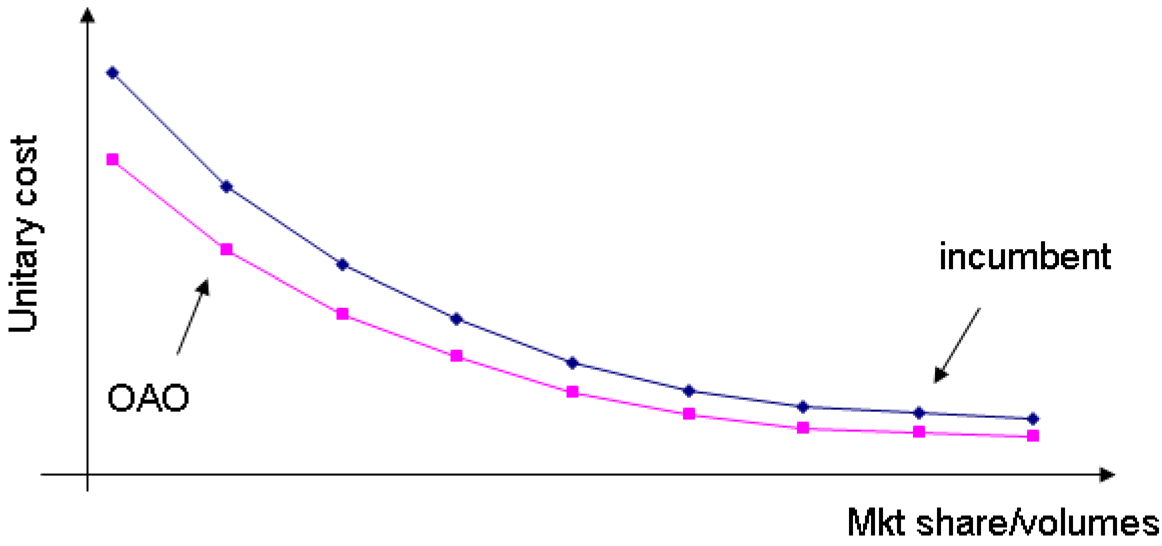
FASTWEB agrees with the goal to ensure that all operators are producing efficiently and that the right of new entrants to recover their costs should be reconciled with the regulatory objective of achieving the maximum level of efficiency in the supply of termination services.
Nevertheless, it is important to highlight that the concept of efficiency needs to be evaluated in light of all the above factors (such as economies of scale and scope, levels of investments, network

architecture, market share, etc.) influencing entry and activities of companies wishing to operate in the affected telecommunications market.
As a general remark, in relation to the often stated need that operators be efficient, it should be noted that non incumbent operators, especially in the fixed market, cannot afford not to be efficient: by definition, since their entry, they immediately need to compete with a well established operator who has completed its network roll-out, in many cases (such as Italy) still has a penetration rate close to 100% of the population and enjoys a number of non negligible advantages deriving from its previous long established monopoly position. Incumbent operators who have thus significant revenue streams coming from existing retail customers and wholesale revenues sold to other operators, completely funded network (in many cases from monopoly positions), EBITDA margins close to 50% and significant profits, can afford inefficiencies (which are often hidden into layers of their vertically integrated structures) but the same is not true for other operators which recur to private financing, are in the stage of deploying their network, are still acquiring customer base and competing on price and quality with an incumbent operator, which – last not least - in many cases also controls a significant portion of their costs and levels of quality via wholesale services. Evidence of the above – and of the effects of altnets dependence on incumbents economic/technical access conditions - are the various price-squeeze cases that have been started at EU and national level and ended with a finding of abuse on the incumbent. This, despite the existence of extensive national regulation concerning non-discriminatory access and transparency in the access conditions. As regards Italy, an example of the above has been the Italian Competition Authority's decision of Nov. 2004 (recently confirmed by the Supreme Administrative Court) imposing on the incumbent fines totalling an aggregate EUR152 million for having abused (inter alia by price squeeze) its dominant position on the fixed network telecommunications services for business customers.

These factors must thus necessarily be taken into account when considering the issue of symmetry of termination rates and duration of glide path and enforcing the concept of efficiency. FASTWEB agrees that NRAs should adopt towards all operators any necessary measures to ensure efficiency (ie. by setting adequate network or price caps) but these measures need to tackle the real inefficiencies and foster entry, rather than deterring new entrants from investing or depriving operators of the possibility to recover the reasonable costs, with an adequate rate of return.

FASTWEB therefore strongly disagrees with the statement that *"symmetric TRs contribute to enhance static economic efficiency (limiting allocative and productive efficiencies), investment and innovation and finally global welfare…*[1]*"*. This statement does not seem to consider the peculiarities of the communications industry, which is characterized by a **high level of sunk costs** and therefore by a significant impact of economies of scale. Operators entering the fixed telecommunications market are in fact faced with high capital expenditures, limited revenue streams and fierce competition (especially from incumbent operators) which do not allow them to completely recover their costs via retail prices to consumers, especially if competing with an operator who has not only already recovered its sunk costs but also is benefiting from significantly higher economies of scale.

[1] Page 7 of ERG consultation document



As illustrated in the above graph, a higher level of unitary costs for OAO does not in any way imply inefficiencies but simply the fact that the alternative operator has not yet reached the possibility of benefitting from the full level of economies of scale, which the incumbent operator, in spite of a higher inefficiency level, is able to do.

Not recognizing this implies ignoring the basic economic principles of the cost structure of telecommunications networks and advocating a return to a de facto monopoly, where only one operator is able to benefit from economies of scale due to a previous legal protection and other operators are prevented from doing so and thus effectively create competition.

Incumbent operators on fixed networks and mobile operators have been allowed to recover costs for their respective networks, i.e. infrastructures built-out in the initial phases, which have been fully repaid by retail prices that have been set in a monopoly regime (for fixed networks) and duopoly/oligopoly regime for mobile networks. Even after liberalization, interconnection charges have continued to allow these operators not only to fully recover their costs but also make significant levels of extra profits. While for the mobile sector, this has been the result of precise political-economic choices aimed at fostering services penetration, in the fixed sector, this has been due to the fact that in most cases cost orientation was not properly enforced by NRAs. In any event, these excessive (or simply not cost-oriented) proceeds were paid by the new entrants on the market.

OLOs are now in the process of rolling out new networks (including NGN networks), without having in whole or in part reached the necessary economies of scale and recovery of sunk costs– most of all – compared to incumbents, without being able to benefit from the scale and legacy revenue streams deriving from former monopolistic and state funded network. In order to be able to bridge the still existing gap and avoid discrimination, OLOs should also be allowed to charge cost oriented termination taking into account the effective costs incurred to lay down their infrastructures and to achieve those economies of scale and scope which would allow them to challenge public funded networks and activities pertaining to the former monopolist.

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 to pursue the objective of either having them phased out or progressively reduced in the long term. But this cannot simply imply imposing symmetric termination rates on all operators: NRAs should rather work on applying all necessary measures to allow full and effective competition on the markets, by removing existing bottlenecks, prosecuting 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.

From an economic standpoint, adequate termination rates give rise to an automatic "**virtuous cycle":** while providing the operator with the means of extending coverage 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 chain of <u>adequate return > network development > scale economies > lower costs</u> cannot be ignored or prevented through short-sighted measures, ignoring the degree of development and liberalization actually reached by the national market.

Relatively higher tariffs in the initial phase do not imply any inefficiencies on the side of the 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 means:

It is important to note that while it is true that in most countries the liberalization process began almost 10 years ago and thus alternative operators should not be considered as "new entrants" anymore, on the other hand the type of competition has changed significantly over this time frame. In the initial stages of the telecommunications "age", most operators entering the market were basically offering only switched base voice services provided to end customers via Carrier Selection and/or Carrier Pre-selection (i.e. using interconnection services offered by the incumbent). With the exception of a few countries with alternative cable infrastructure, direct access by alternative fixed operators did not exist since ULL started to be effectively available after 2002 (for example, in Italy though ULL was theoretically introduced in 1998, the first lines were unbundled at the beginning of 2002).

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 relevant disadvantages of not having reached the necessary economies of scale that will allow them to optimize the cost structure (again not because of any inefficiency but only due to the cost structure of the network deployment). Given the above circumstances, the choice of imposing the same level of symmetric rates based on the economies of scale, market shares and level of depreciation of the traditional networks of an incumbent operator (in many cases fully depreciated), would not seem to be proportionate and to represent a clear disincentive to investment and promotion of competition, but rather would end up pushing operators away from an infrastructure-based competition model versus the adoption of simple resale-based competition model, where wholesale services have to be bought from the incumbent. If this were the case, the serious risk is the re-monopolization of the telecommunications market in the hands of incumbents and the interruption of the liberalization process initiated in 1998.

Moreover, it should be noted that, where competitors have limited market shares, the impact of higher termination rates is itself limited if not negligible on the market; nevertheless if competitors are allowed to recover 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. There is therefore very limited risk of negative impact on consumers; actually the presence of infrastructure based competition will only bring benefits to consumers. Moreover, it should be taken into account that, notwithstanding the level of termination rates applied, pricing policy towards clients has in any event to take into account and to compete with the effective prices applied – *inter alia* – by the incumbent operator (including e.g. reductions applied to a specific client or promotions): therefore, whichever level of termination rates is allowed, OLOs cannot really afford to reflect their rates in the final tariffs. Therefore, it may not be stated that consumers pay the price of differences in tariffs but rather that – under the current framework – OLOs themselves bear the retail burden of a very negligible wholesale "advantage". On the other hand allowing incumbent operators with market shares higher than 50% (in many cases even over 70-80%) the possibility to differentiate on-net and off-net tariffs would be highly discriminatory and anticompetitive.

It needs to be remembered that in order to allow competition in the communications market all operators need to be given the same means to recover their costs, especially in view of the high level of initial investments in network roll-out. Incumbents have been given these means since their network was deployed in a monopoly position thus with the possibility of recovering costs via end user, public funding and high retail tariffs possible due to the absence of competition. Incumbents' current termination rates thus represent the cost of an operator with very high penetration levels, market share and call volumes and which has completed the network roll-out. Assuming the fairness of such level of termination rates for new entrants who, in most cases, are in a completely 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.

Setting a symmetric termination rates in principle is correct in similar or at least comparable circumstances (which is not always the case in many Member States). Also, due to the particular situation of the communications markets in many countries, the need to foster infrastructure based competition and invest in NGN and NGAN networks by new entrants, particular attention must be placed on this issue.

1.1.1. The concept of Non discrimination and Technological Neutrality

The European Regulatory Framework is based on the objective of promotion of competition which 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 (ie. the incumbent operator and the mobile operators) and on 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.

1.1.2. The inclusion of Access Costs

The fact that currently termination rates do not include access network costs is in our view due to the fact that in most cases termination rates reflect the cost structure of incumbent operators, which, as already stated above, have had other means of financing the access network in the monopoly stage, and even in the case upgrade to NGAN infrastructure can make use of existing infrastructure and already have the revenues from existing customer base and market share[2].

This is obviously not the case for alternative operators, which – as explained above - find themselves in the situation of investing in the deployment of infrastructure and the new competition model which is progressively phasing out competitive models based on Carrier Selection and CPS versus competition models based also on competition in the access segment via ULL or proprietary infrastructure.

A clear example is represented by mobile operators, which - due to the need to build their own access infrastructure - have been allowed to include not only all the network costs (including access costs) in the termination rates, but in most cases also commercial costs, costs of terminals, marketing costs, etc.[3]

The circumstance that mobile operators are increasingly competing in the fixed market via integrated offers definitely leads to a competitive and unfair disadvantage for fixed network operators who are not vertically integrated with mobile operators. Among the possible solutions described by the ERG document which are:

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

the only possible and non discriminatory solution would be the first one. The removal of access costs for mobile operators cannot solve the issue of discrimination and distortion of competition. Mobile operators have had the benefit of the inclusion of access costs since market entry and excluding them in a later stage after the network roll-out is completed is correct (as has happened for incumbents for which there is no need to include access costs in termination rates since network is completely deployed). Nevertheless, for alternative entrants in the fixed market, this is not the case since they are still in the initial phases of network roll-out and excluding the inclusion of access costs from termination rates would impede or slow down this deployment. Furthermore, it seems unclear how the issue of non discrimination could be avoided. Not allowing fixed alternative operators the

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2 See ERG Consultation document on Regulatory Principles of NGAN (ERG (07) 16) on the economic barriers to NGAN deployment by new entrants and the Analysis study in which sub-loop ULL was economically feasible with a 45-50% market share which only incumbent operators already have.

3 This is the case for example in Italy in which mobile operators have been allowed to include commercial, marketing costs, access costs, customer care, cost of terminals and SIM.

inclusion of access costs in FTRs based on the argument that they would be removed also from MTRs does not solve the issue. Mobile network operators have had this benefit so the removal is no harm to them, whereas fixed operators have never had this benefit so they would be at a disadvantage.

As the Italian regulator AGCOM has stated in the consultation document on the separation of the network and perspectives for NGN development[4]:

"One of the peculiar characteristics of the Italian regulatory model is the choice to allow, through the termination service, a remuneration- even partial- of investments in network infrastructures with a capillarity and independent from the incumbent operator's network (with the exclusion of the access network). Only by guaranteeing an adequate remuneration it is possible to foster the relevant investments necessary to realize network infrastructures. To this purpose, AGCOM has allowed termination charges on alternative's operator networks to be higher than the ones requested by the incumbent. 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 greater market risk deriving from the presence of an operator with significant market power, with relevant difficulties to obtain authorizations from local authorities for civil works, fewer economies of scale, greater difficulties in accessing capital markets. 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 is 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" (Emphasis added).

1.1.3. Differentiation of retail tariffs

While FASTWEB supports the principles that all operators need to be allowed to recover their costs and thus also the costs of termination on other networks, this cannot imply the possibility for incumbents to adopt discriminatory practices for retail pricing (such as on-net/off-net discrimination of pricing) which are clearly aimed at and would inevitably result in the exclusion of competitors from the market. The risk of discriminatory and abusive behaviour is obviously a function of the incumbent's and competitors' market shares. However in many member states the incumbent's market share in the retail market is still greater than 60% (as regards Italy, such share reaches 70%) and therefore there is definitely a risk of discriminatory behaviour, in case these powerful players are allowed to differentiate between on-net/off net. Moreover, should this type of practices be allowed, there would be a clear clash with well established principles of competition law, specifically imposing on the dominant company a special responsibility to avoid any behaviour which would be able to distort sound and fair competition on the market and in particular not to adopt any

[4] See paragraph 4.4. page 70, of Exhibit B to AGCOM's Decision no. 208/07/CONS, initiating a "*Public Consultation on the Regulatory Aspects Relating to the Access Network Structure and to the Prospects of the New Generation Broadband Networks*" ("Exhibit B to AGCOM Decision 208/07").

exclusionary behaviours. Now, the impact of discriminatory rates imposed by an incumbent having – such as in the Italian case – more than 94% of the access market (i.e. of the clients supposedly affected by on-net rates) would grant the incumbent precisely the advantages and exclusionary means, which both ex post and ex ante regulation clearly aim at avoiding.

This does not mean that incumbents should bear the costs of higher termination rates (temporarily) granted to alternative operators. First of all, since termination rates of alternative operators are a function of market shares, higher termination rates will be linked to (much) lower market shares – compared to those still owned by the incumbent - and thus the impact of such rates on the retail market would be quite negligible. Secondly, incumbent operators should in any event be allowed to recover their costs rather than via on-net/off-net discrimination, only through average prices, in order to limit the risk that competition is distorted.

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

Regulatory accounting methodology has up to now been based on traditional incumbent's PSTN network infrastructure. This causes the need to review traditional accounting criteria and adapt them to the new NGN architectures and logics.

A fundamental characteristic of NGN networks is the de-centralization of network functions to peripheral network elements also at the customer site. 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.

Moreover, 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 – which would be able to include e.g. 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.

It is important to note that in the only two cases of NRAs (BIPT and AGCOM) which have analysed regulatory accounts and cost models of new entrants and have therefore been able to consider different architectures based on VOIP technologies of the new operators vs. the traditional PSTN networks of the incumbents, these costs elements have correctly been considered as part of the core network and included in termination charges.

1.1.5. Accounting methodologies for new entrants need to be adapted to specific market situations

Until now, NRAs have in general adopted different regulatory accounting and methodological criteria for the fixed network of the incumbent operator and for mobile operators who have been notified as SMP and subject to cost orientation obligations.
For example, in Italy, AGCOM has allowed mobile operators the allocation of several cost elements to the voice termination service which are not strictly related to the network such as commercial and marketing costs, costs of terminal equipment, cost of SIM cards, etc. Some of these costs have been removed in 2006, but AGCOM has maintained a mark up in the termination rates to take into account the "network externality benefits". This in spite of the fact that today penetration levels for mobiles have reached over 130% and market shares of main mobile operators are very high (ie. In Italy for example the combined market share of TIM and Vodafone is close to 80%).
The rationale for inclusion of these cost categories within the voice termination service was the need to foster investments in new mobile networks. Other EU countries have adopted similar measures and have allowed a mark up for network externalities, with regards to mobile operators. In the case of traditional incumbent operators in the fixed network, these "network externalities" were not applicable, precisely because of the circumstance that in most cased penetration levels of the incumbent were above 90%.
The principle of technological neutrality in the European regulatory framework should imply that NRAs cannot favor a specific technology (i.e. mobile vs. fixed) by allowing some operators in similar market situations more favorable terms.
The situation of alternative operators who are investing in fixed networks is similar (even if less favorable) to that of mobile operators who were investing in mobile networks. A different treatment would imply a discriminatory approach which should not be coherent with EU regulation.
To foster investments in NGN networks by new entrants and avoid the risk of discriminatory treatment by NRAs among operators, it is necessary to allow OLOs to recover part of the costs of the access network (or in alternative include a mark up for network externalities) also in termination rates.

FASTWEB disagrees with some of the statements contained in the ERG consultation documents relating to the possible reasons in favor of FTR symmetry where it is stated that:

"While the promotion of entry may have been justified in the past, there are perhaps less reasons to believe that it would be effective in the future (irrespective of whether it was effective in the past). While in the past fixed telecoms operators essentially provided a limited range of telephony services, in recent years operators have been able to use the same network to provide a wide range of services, including broadcasting and broadband Internet in addition to telephony. This means that revenues from termination services are proportionally likely to become less important for all operators, incumbents and OAOs alike.
As such any entry assistance policy based on higher OAOs FTR is likely to be less effective than in the past. Given that the higher FTRs of OAOs translate in higher prices for calling these networks for

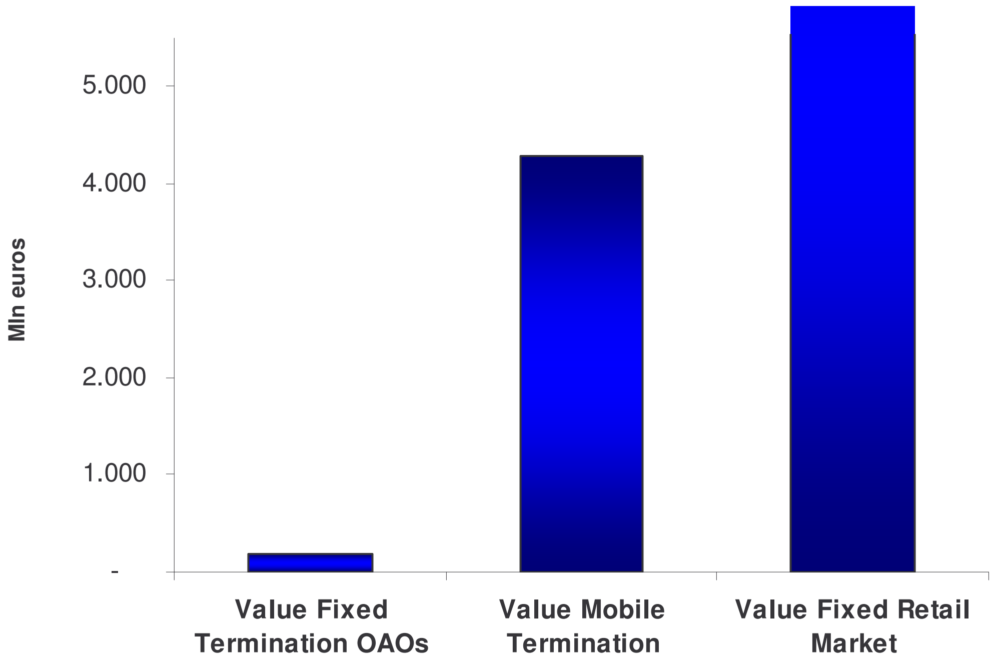
consumers, if they are unlikely to promote more competition in the long run, they would be significantly less justifiable than in the past.[5]*"*

While it is true that the range of services offered via fixed telecommunications network has grown and most operators now offer double and triple play offerings, this does not undermine the fact that operators need to recover their costs for all the services. Cost allocation methodologies allow for the possibility to allocate costs to the different services (ie. voice, data and video) and thus termination rates will reflect the costs of the voice services through adequate cost allocation drivers. So the fact that operators offer a wide range of services does not change the fact that all operators be given the same opportunities to recover the specific costs of each service or eliminate the issue of economies of scale relative to voice termination.

With regard to the translation into higher 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 which determines the impact on the retail market. Since especially in the fixed market, market shares of OAOs are limited, the overall impact on the market will be limited if not negligible.

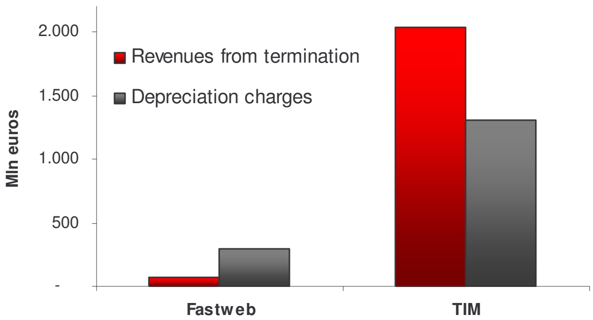
The figure below relative to Italy, a country in which the NRA has allowed asymmetric rates illustrates how regardless of the levels of the rates, the impact on the market is extremely limited. Just to provide some comparative figure, the value of all asymmetric termination for altnets in the fixed market is less than 200 mln. euros per year compared to almost 5 Bln euros per year of mobile termination rates.

[5] See page 35 and 36 of ERG Consultation Document under paragraph 6 "reasons of FTR symmetry"

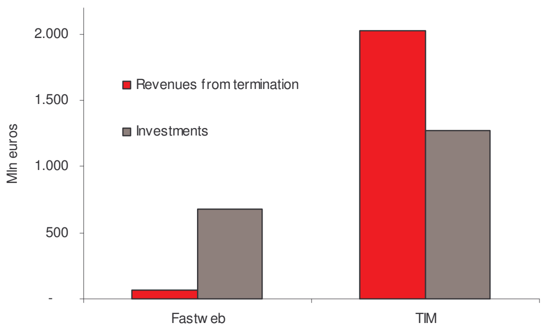


Also, if revenues from termination rates are compared with the level of investments of each operator, it is evident that while for the fixed network altnets, termination revenues are linked to effective investments being made in new infrastructure deployment, in the case of the mobile operators (especially for the biggest operators) this is not the case, as can be seen from the following graphs:

Graph 2a: ratio between depreciation charges and termination revenues- Fastweb vs Telecom Italia mobile



Graph 2b: ratio between investments and termination revenues- Fastweb vs Telecom Italia mobile



Since the level of investments and annual depreciation charges can be considered a good proxy of effective costs, the ratio between these factors and the revenues from termination charges can be considered a good indicator of the cost orientation of termination rates and the existence of extra-profits. While in the case of Fastweb (which can be considered an example of an alternative operator in the fixed market with higher than average levels of investments), termination revenues represent a small portion of the annual depreciation charges and levels of investments, for mobile operators termination revenues are over 150% of total annual depreciation charges and investments, thus clearly indicating a significant level of extra-profits not justified by cost orientation.

So, in the case of Fastweb, revenues from termination effectively contribute to the investment necessary to increase network roll out, in the case of TIM revenues from termination are significantly in excess of network costs and investments and constitute a clear violation of the cost orientation principle.

In the fixed market, setting all rates at the same level on the basis that it would "*provide incentives to be efficient*" avoids to take into account the fact that only one operator on the market has already fully deployed its network and has the economies of scale and volumes to fully recover its costs and make a reasonable margin (ie. the incumbent), while all other operators would be penalized and not allowed to grow and effectively compete on the market.

As already stated, Fastweb agrees with the principles that NRAs should provide all operators incentives to be efficient, but general principle needs to be applied correctly and proportionally taking into account the different market situations.

Though the impact of economies of scale needs to be evaluated in order to determine the period of the glide path and the target level of FTR rates for OAOs, it is without doubt that they have s a relevant impact in the telecommunications market.

FASTWEB cannot endorse in any way the statement contained in the consultation document 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 diseconomies 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 fundamental assumptions behind network economies and 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 favor only 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 on the statement 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 - which appears to be the aim of the Italian NRA itself (AGCOM: "**service-based competition** has a limited role and it is therefore necessary to ensure in Italy further **infrastructure processes** in order to make the market more **competitive")** - OAOs need to reach a national scale in order to effectively compete with the incumbent and for this purpose appropriate incentives should be provided 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 licence but this was also because of the limited amount of licences (and therefore less degree of competition vs. the fixed market) and the specific characteristics of the mobile market and the fact that mobile operators were able to recover the costs via termination rates.

Finally, with regard to the statement according to which operators being granted asymmetric rates would have the incentive to set high call termination charges, which raise competitors' costs and create a distortion of competition, this can be easily avoided by providing to all operators appropriate non discriminatory and proportionate criteria for the definition of termination rates, based on specific circumstances and market situation of each operator, as a starting point and establishing a network cap and incentives for reduction of termination charges in line with market share or an appropriate temporary glide path.

1.1.6. Possible developments: bill and keep

In the long term, the shift to bill and keep arrangements is certainly a positive development and 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 and especially create disparity between vertically integrated operators (typically incumbents in fixed markets which also own a mobile operator) and non integrated operators (typically altnets in the fixed market).

1.1.7. QUESTION G3: Finally, we would like to ask you to elaborate on the question of converging MTR and FTRs and the timeframe you envisage for this.

On the issues of convergence of fixed and mobile termination rates, Fastweb believes that there should be no discrimination among technologies by NRAs through more favorable treatment of mobile operators vs. operators on the fixed market.

Different treatment can only be justified based on different market and competitive circumstances but not on technologies. In this respect, we believe that NRAs should ensure the cost orientation for mobile operators who are subject to cost orientation obligation and avoid that excessive profits from mobile termination are used to subsidize entry into fixed or broadband market.

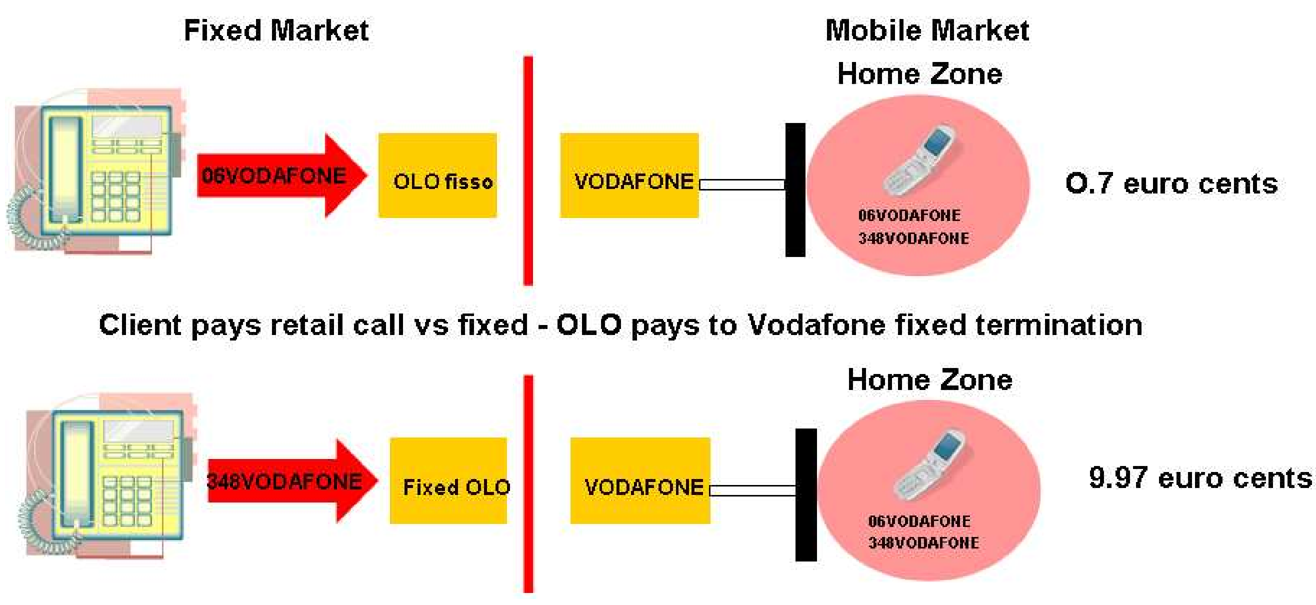
NRAs should thus enforce cost orientation, accounting methodologies and principles on mobile operator. For example, if the methodology adopted by NRAs for the evaluation of termination rates for alternative operators in the fixed network is a bottom-up LRIC model, the same approach should be adopted for the evaluation of termination rates for mobile operators. If “bill and keep” models are introduced, they should apply to both fixed and mobile termination simultaneously.

1.2. Answers to questions F1-F13

Question F1: how do you think termination should be regulated in a converging fixed-mobile market

Fastweb believes that in a converging market it is essential that both mobile and fixed operators are given the same opportunities for cost recovery and that subsidies deriving from extra-profits from mobile termination are eliminated. If this were not the case, mobile operators could subsidize entry into fixed markets creating distortion of competition due also to discriminatory practices.

As an example we would like to highlight the case of Vodafone Home Zone, a service recently launched in Italy by the mobile operator Vodafone according to which for the same service two different termination rates are offered.

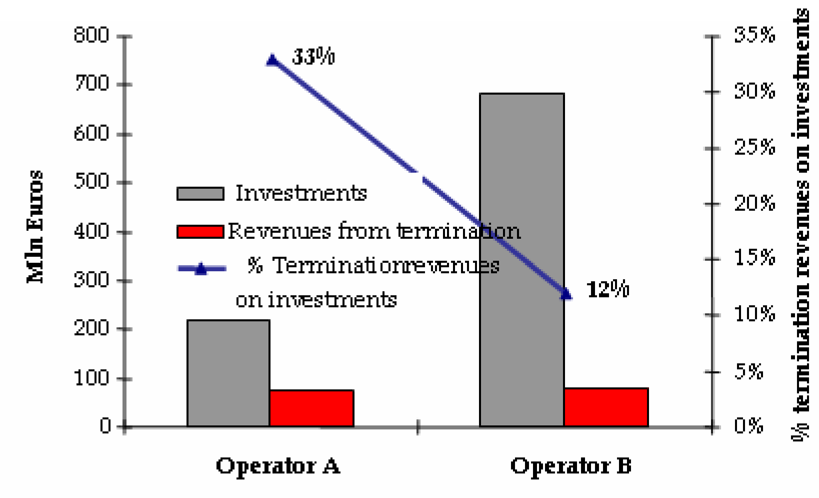


Since the termination is related to exactly the same network resource, the fact that two different termination rates are applied in spite of obligation of non discrimination and cost orientation imposed on Vodafone poses the following questions:

- What is the true cost of termination on Vodafone's network?
- How is it possible to apply different costs to exactly the same service and at the same time respect the principle of non discrimination?
- Are mobile operators using excessive profits on the mobile termination to subsidize entry into fixed markets?

Question F2: Do you agree on the methodology and assumptions underlying the asymmetry index calculations?

Fastweb believes that especially for the fixed market characterized by the presence of significant differences among operators, any asymmetry index needs to be take into account other factors such as market shares and levels of investment in order to be significant. This is because an asymmetry index based only on nominal values fails to consider specific circumstances which may justify the level of asymmetry.
The example below aims to better illustrate this point. Operator A in Member State A has a termination rate of 1 euro cents (so it would be considered a small degree of asymmetry) whereas Operator B in Member State B has a termination rate of 3 euro cents (thus considered a high level of asymmetry). Nevertheless, since operator A has larger market shares and lower levels of investments compared to operator B, the effect is that in spite of lower termination rates, Operator A is able to recover a greater portion of investments and costs than operator B. So in practice, Operator A has a higher level of asymmetry than operator B.



So, as is clearly illustrated by the graph, in spite of the high levels of investments made by Operator B , the termination rate requested which is on a nominal level higher than that requested by Operator A, due to the fact that Operator A has a higher market share and lower levels of investments, it is able to recover a much higher proportion of investments vs Operator B, resulting in a higher level of de-facto asymmetry.

Question F3: Do you think the list in paragraph 7.1 constitutes an exhaustive list of the possible reasons justifying the adoption of asymmetric tariffs?

Fastweb agrees with the list provided in the ERG consultation document (paragraph 6.1) which are:

- Economies of scale
- Increase of new entrants profits and market shares
- Different network coverage
- Lower bargaining power for equipment

Nevertheless, we believe this list not to be exhaustive and also that the point relative to increase of new entrants profits and market share may be misleading. Asymmetry should not be justified on the basis of allowing operators to make extra profits but on the basis of allowing an operator to recover its costs and therefore provide incentives for investment and growth. It cannot therefore be regarded as a form of entry assistance but rather as a symmetric and non discriminatory treatment vs other operators on the market which have been fully allowed to recover their costs in the initial phase of network deployment and commercial roll-out.

Question F4: Do you agree on the fact that any entry assistance policy for the future based on higher OAOs FTR is likely to be less effective than in the past?

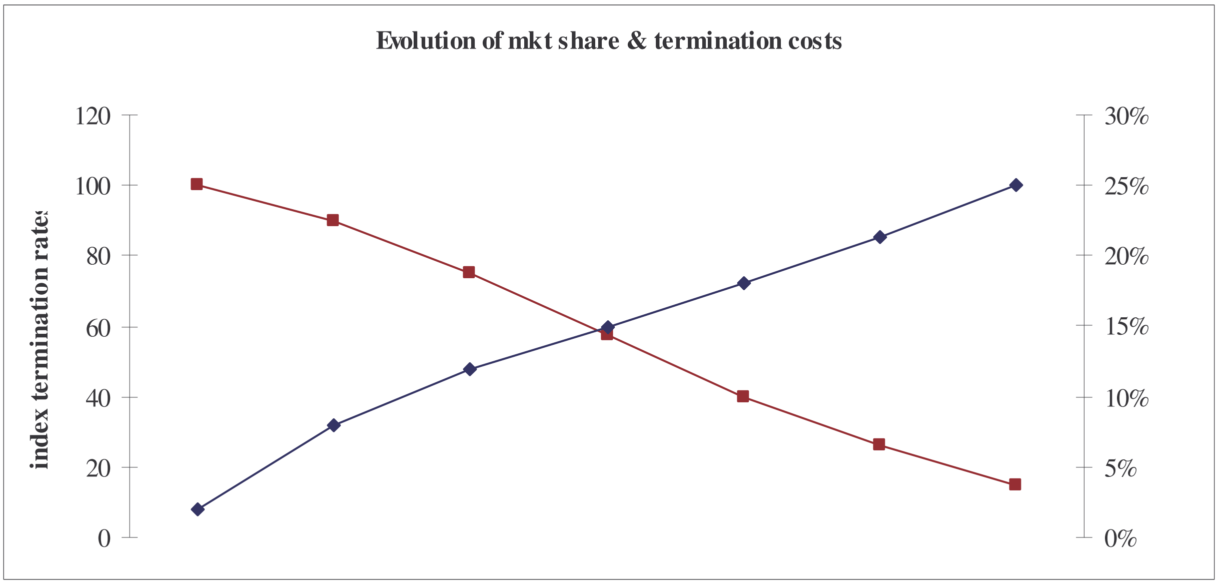
Fastweb disagrees with this statement since operators are in the process of investing in new NGN networks and therefore we are in a new phase of competition where there is a need to promote infrastructure based competition especially in countries with limited alternative infrastructures. While new NGN based technologies will certainly be more efficient in the medium-long term compared to traditional PSTN infrastructure, they are based on a higher level of fibre in the access network and ADSL infrastructures via ULL which actually require significant levels of initial investments than in the past.

Question F5: Could you please provide a definition of an efficient operator NRAs should refer to in fixing FTRs? What are the costs an efficient operator would incur to provide termination services?

The concept of efficiency in telecommunications market needs to be evaluated in similar or at least comparable circumstances. An operator who is entering the market and investing in its own infrastructure cannot in any way be considered inefficient only because it has not yet reached its optimal level of economies of scale nor can an operator be prevented from investing in own infrastructure rather than buying wholesale inputs from the incumbent because of the fact that it will increase its sunk costs and have a delay in reaching economies of scale. There is inevitably a trade off between an infrastructure-based model and resale-based model which if considered on the basis of the level of "efficiency" in the short term would promote only resellers and avoid infrastructure based competition, which should not be the case.

We believe NRAs should not via the imposition of symmetry or a level of termination rates that does not allow an operator to recover costs, favour a specific business model or investment strategy. Efficiency can only be evaluated in the medium/long term so NRAs should have a "neutral approach" while at the same time ensuring adequate incentives for growth and efficiency. This can be achieved for example by giving operators a reasonable time period to prove the validity of their business model and reach a reasonable level of economies of scale. Alternative operators in the fixed network are usually more efficient than incumbents in terms of costs not related to economies of scale (they cannot afford not to be efficient) and usually will be able to reach comparable unitary costs of the incumbent in spite of lower market shares, proving a higher level of efficiency.

As an example, an alternative operator should be able to reach a similar level of unitary costs with the incumbent with only a 20-25% of market share (versus a more than 50% market share of incumbent for example), proving to have a greater level of efficiency. Nevertheless, in order to reach this level of efficiency, it is essential that an alternative operator be able to recover its costs, so the reduction of their unitary costs may be more than proportional to the increase of market shares.



This objective can only be achieved if NRAs allow asymmetry for a reasonable time period in order to allow cost recovery and growth and at the same time define an objective and a network cap to encourage the achievement of growth. As already said, the higher levels of unitary costs, will be linked to low market shares and therefore the impact on the market in the short term will be limited while in the medium-long term there will be the added and durable benefit of sustainable competition.

Question F6: Do you think that OAOs should be as efficient as the incumbent?

As already said in question F5, OAOs in general are more efficient than the incumbent with the only exception of cost factors outside their control related mainly to economies of scale and the benefits of vertical integration of the incumbent. We believe more focus should be put by NRAs on ensuring efficiency on the incumbent on the wholesale services sold to new entrants rather than on the termination rates on new entrants which have a limited impact on the market and have less possibilities of real inefficiencies due to their market and financial situation.

Question F7: Do you agree on the fact that there are less reasons for fixed operators compared to mobile operators that justify the adoption of asymmetric tariffs?

Fastweb does not see any reason for which fixed operators who are building their own infrastructure should not have the same justifications as those adopted for mobile operators. Actually, in the case of the fixed market the reasons that justify asymmetry are even greater that those for mobile operators in terms of:

- Level of competition
- Barriers to entry from other operators
- Levels of investments
- Speed of network roll-out
- Difficulties of connecting new customers and acquiring client base

Question F8: 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?

Fastweb believes that cost orientation is the best mechanism to avoid a distortion of competition. This does not obviously imply that NRA should accept any level of costs regardless of any evaluation of efficiency and reasonableness of charges requested but that operators cannot be penalized for factors outside of their control such as economies of scale or competitive disadvantages compared to the incumbent. Also, once NRAs evaluate the initial charges of an operator, based on costs and taking into account the factors above, they could foresee a network cap mechanism which ensures the adequate incentives to the OAO for growth and therefore a reduction of the termination rates.
Not allowing this path, creates, as already said above, a distortion of competition, since the market would be seriously biased by the fact that only one operator (the incumbent) would be able to recover costs and other OAOs would be forced to limit their investment and change the business model from infrastructure based competition to resale, which in the end would be contrary to the purposes and objectives of the European Directives.

Question F9: Do you agree on the fact that symmetric tariffs would allow to avoid transaction and regulatory costs?

We do not see a direct link between symmetric tariffs and transaction costs but obviously asymmetries raise regulatory costs in terms of extra activity by the regulator to evaluate the level of termination rates requested by operators. Nevertheless, this cannot justify the imposition of symmetry only on the basis that it is simpler to regulate since on the other hand it would be against the basic principles of regulation which should be the promotion of competition. There are ways to simplify the regulation of asymmetries which would be the evaluation by the NRA of maximum ceilings for termination rates of OAOs, based either on an initial evaluation of costs of operators or some other methodology defined by the NRA (such as a cost model) and the imposition general network cap to ensure reduction of rates, while at the same time providing operators with the possibility of requesting different rate levels based on objective circumstances and cost evidence, subject to evaluation by the NRA. This approach would minimize regulatory costs but at the same time safeguard the principle of allowing cost orientation, where justified.

Question F10: Do you agree on the fact that NRAs should reach symmetry in fixed termination tariffs within a reasonable time period?

We agree on the fact that termination rates of OAOs should be subject to a network cap in order to ensure a decrease over time but at the same time disagree with the principle of strict symmetry if this symmetry is based on the costs of the incumbent which has completely different characteristics with the other operators and in any case will have a different cost structure and the benefit of greater economies of scale. We think that target rates for OAOs and incumbents should be based on objective circumstances taking into account the specific characteristics and market situations of each type of operators. We agree with the reduction of termination rates in a reasonable time period related to reasonable hypothesis of market share growth for OAOs but strict symmetry should be evaluated in light of market circumstances and differences in cost structures. Even though symmetry may be used as a target, there should always be the possibility of burden of proof by operators in order to allow some degree (even if limited) of asymmetry where justified.

Question F11: 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?

We agree that in any case NRAs should allow a transition period to move to symmetric FTRs though as already stated above, we believe that the target termination rates can also not be symmetric but should be evaluated for each operator taking into considerations the following aspects and individual characteristics in terms of:

- level of infrastructure competition in the market
- market shares of incumbent in the access network
- time of entry of each operator
- level of network investments by each operator
- economies of scale

In any case, the transition period defined by the NRA should not be strictly linked only to a certain number of years, but subject to the evaluation of the existence of barriers to effective competition and growth on a national level.

Question F12: In your opinion what criterion should NRAs adopt to set the glide path?

The glide path should be in any case linked to the levels of investment, costs and market share of each operator. Altnets will differ significantly in size, investments, costs and business models so the definition of a single glide path applicable to all may be misleading and discriminatory. Simmetry in principle should be achieved in comparable circumstances, therefore imposing symmetry for all regardless of specific circumstances may reward some operators and penalize others even with the same level of efficiency.

NRA should define as a starting point the effective costs of the operator (based on FAC model) and the glide path both in duration and level of rates allowed should be determined based on the evaluation of reasonable evolution of market share.

Question F13: As the length of the glide path is a controversial point, in your opinion, should the time period to reach symmetry be the same for all NRAs or should each NRA determine it according to national circumstances?

As said above, since market features in each Member State are significantly different, each NRA should be free to determine it according to national circumstances. The level of economies of scale is highly dependent especially on market shares and volumes achieved so NRAs in Member States with a less developed level of competition should define a longer glide path.

2. MOBILE CALL TERMINATION

General comments:

A part from the considerations contained in paragraph 1.1.5 above which apply also to the mobile termination, Fastweb would like to stress the fact that traditionally the mobile market has been very protected both in terms of limitations of market entry by other operators and the fact that in most cases no access obligations have been imposed to increase competition, there has been a very favourable termination rate policy (scarce enforcement of cost orientation in spite of existing regulatory obligations, favourable methodological criteria for cost accounting which have allowed the inclusion of all network costs, including access, commercial and marketing costs, costs of terminals, externality benefits, etc.).

We believe that such policy may have been justified initially due to the need to build out new networks but the situation has now changed since in most cases networks have been rolled out and this policy has transformed into excessive profits which are no longer justified and actually are discriminatory and creating competitive distortion especially in view of fixed-mobile integration and the entry of mobile operators into the fixed market.

The fixed market since the liberalization process has been characterized by interconnection and access obligations on the incumbent operator and a stricter enforcement of cost orientation which has allowed the entry of multiple operators and a significant pressure on retail prices, whereas the price pressure on the mobile market has been much more limited.

Another issue to highlight is the scarce visibility of regulatory accounting of mobile operators and the total absence of transparency on the costs of mobile operators imposed by NRAs. This discriminatory treatment is a cause for concern in view of the fixed-mobile convergence both for voice, data and content and the fact that access to the mobile market is still very limited since very few NRAs have introduced access and cost orientation obligations as in the fixed market to allow fair competition.

The ERG consultation also fails to address the issue of SMS termination which NRAs in our view should regulate as well due to the relevance of SMS in the mobile market and the entry of new operators such as MVNO/ESPs. The cost of SMS termination is significantly higher than mobile termination if one considers the network occupancy of such service. As an example an SMS termination rate of 5 euro cents/min would be comparable to a per minute termination of 3 Euros (25-35 times more than mobile per minute termination) in spite of significantly lower costs of terminating an SMS.

ERG and NRAs should thus include the issue of SMS termination in the discussion and analysis of mobile termination rates.

The problem is thus that NRAs should ensure non discriminatory treatment between fixed and mobile operators and ensure to all operators (especially alternative operators who are in the process of building out their networks) the same opportunities to recover costs and compete on the market for convergent services.

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

As a general principle, symmetry should be compared and imposed only in similar circumstances and the imposition of symmetry for all regardless of the consideration of objective cost differences is discriminatory and only favours incumbent or more established operators. What NRA should enforce is effective cost orientation for all and avoiding unjustified extra profits by operators.
To this regard, if the focus of regulators is symmetry regardless of cost orientation, it may imply that the first or second mobile operators in a market who may have the lowest levels of termination rates compared to the third or fourth operator but these levels in any case allow them a significant amount of extra-profits due to various factors such as economies of scale, advanced level of depreciation of their network, etc.
A good example is provided by the Italian market in which the termination rate of the first and second mobile operator does not represent an effective cost orientation and still allows these operators unjustified extra profits. The focus of NRAs should thus not be on imposing symmetry on the third and fourth operator on the market but rather to make sure that each operator is allowed the same level of cost recovery and the same ability to compete.

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 licencing holdings. Can you identify other exogenous factors?

A significant factor which is reflected in unitary costs are the traffic volumes and market share. A later entrant in a market where 1 or 2 operators for example already have an established presence and market shares over 40% each, will certainly have more difficulties than the other operators in acquiring market share and this is certainly an exogenous factor outside of his control.

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"?

Yes, certainly spectrum allocation differences may have an impact in the network cost in terms of the number of sites for example needed for UMTS coverage vs GSM coverage. Another factor to be considered on the other hand are the savings for operators who have both GSM/UMTS frequencies allocated who can benefit from synergies and greater economies of scope and scale so these operators should have lower unitary costs of MTRs.

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 the transitory period"?

The mobile market is characterized by a substantial oligopoly, also taking into consideration the effective barriers to entry due to unavailability of frequencies and the absence of regulation which imposed access to mobile networks (market 15). This has created a significant difference in the liberalization process compared with the fixed market in which through regulatory measures (CPS, CS, ULL, Wholesale Access, Bistream, etc.), a greater level of competition on the retail market has been achieved with a consequent pressure on prices. We therefore believe that NRAs should adopt any measure to increase competition in the mobile market and not only allow entry by other players but also achieving a more levelled playing field among existing operators and offsetting the competitive advantages of the larger mobile operators (especially if vertically and horizontally integrated).

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

The concept of reasonable needs to be better defined. In absolute terms, it should be considered reasonable to allow each operator the same opportunity to recover its costs. If the strict application of this principle has an output of unitary costs which are considered excessive, then the NRA should perform a more detailed analysis to evaluate the maximum level of a tariff which can be considered reasonable taking also into account the overall impact on the market.

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

As stated for FTR, symmetry should be evaluated in similar circumstances. The only difference in the mobile market is that operators tend to me more similar in size (especially for network coverage) and the main difference may be due to spectrum allocation and traffic volumes rather than significant differences in levels of investment or network architecture, therefore it may be easier to consider a cost model which could apply to a theoretical mobile operator.

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

Yes, as already stated for FTRs, due to the differences in the market situations in the various Member States, each NRA should evaluate the transition period accordingly. Non discrimination means the application of similar remedies in similar circumstances and situations, so applying the same remedy regardless of the specific situations would be illegitimate.

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?

The only way to limit the competitive distortion stemming from the fact that MTR tariffs are significantly above MTR costs is to ensure effective cost orientation for all operators taking into account the specific circumstances of each operators.

Question M9: Do you agree that NRAs should first try to set MTRs at cost?

Fastweb believes that the real asymmetry in the telecommunications market is the fact that while fixed line operators in spite of the fact of not being subject to strict cost orientation obligations are de facto being forced to cost orientation (and in many cases termination rates are actually below effective costs), while for mobile operators who are by the existing regulation subject to cost orientation, NRAs are not enforcing this principle. This causes a competitive distortion due to the fact that in most cases mobile operators are vertically integrated with fixed operators (especially incumbents in the fixed network who also have in most countries a mobile operation, but also mobile operators like Vodafone who is now entering the fixed market) and can use the excessive profits from mobile termination to subsidize offers in the fixed market.

Conclusion

In conclusion, FASTWEB believes that the current debate on termination rates should be focused on ensuring that, on one hand operators (both on fixed and mobile markets) are able to recover their effective costs without excessive profits, and that NRAs ensure the application of non discrimination principle (meaning the application of same criteria in similar circumstances), technological neutrality (meaning that NRAs should not favour a specific technology- ie. mobile vs fixed) and taking into account the objectives of non discrimination and promotion of investments (meaning that all operators should be given the same incentives to invest and obtain a reasonable return on capital employed and eliminating unjustified extra-profits on mobile termination), fostering innovation and bringing durable benefits to consumers deriving from the development of sustainable competition.

The objective of the European regulatory framework is the creation of a sustainable competitive environment, which can only be realized through infrastructure based competition and termination rates can play an important role in sending the correct investment signals.

This is particularly important in today's scenario of fixed to mobile convergence and of the increasing need of deploying NGN networks and investing in new broadband access infrastructures.