ERG

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Response to ERGs draft Common Position on symmetry of fixed/mobile call termination rates

Tele2 is Europe´s leading alternative telecom operator offering a wide range of products to consumers across Europe. Tele2´s most important products are mobile telephony and broadband but the company also provides fixed telephony in a number of countries. Tele2 welcomes the opportunity to provide its comments on ERGs draft Common Position (CP) on symmetry of fixed/mobile call termination rates.

General

As a general remark on the draft CP Tele2 would like to point to the fact that before the question of symmetry regarding termination rates becomes relevant and a potential issue a NRA first must come to the conclusion that at least two operators in a specific country are considered holding SMP-position on their individual networks. This is due to the fact that price regulation of any kind can only be decided as a remedy following a finding of SMP-position according to Article 13 of the Access directive. Court judgments across Europe (e.g. in the UK, Finland and Ireland) show that an SMP assessment is not a mechanical process where the fact that an operator per definition holds a 100 percent market share on the individual market at hand can be used as a sole argument for the conclusion that the operator also holds a SMP-position in the market. The existence of customers with a strong negotiating position, which is exercised to produce a significant impact on competition, will tend to restrict the ability of providers to act independently of their customers. Incumbents across Europe can for instance, due to their size and countervailing buyer power, effectively stop an attempt to increase prices by sellers of fixed termination. Many factors play a role in determining the scale of countervailing power on the part of the buyers and this issue must among others be taken into account by NRAs in their SMP-analysis.

Tele2 finds the draft CP in some parts lacks fundamental academic analysis and is not comprehensive enough to comment in detail. For instance the question “Could you please provide a definition of the “efficient operator” NRAs should refer to in fixing FTRs?” holds a number of very difficult issues that would most probably merit a comprehensive

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study of its own. This question has arisen in some member states (e.g. Sweden) upon building LRIC-models to be used for setting regulated termination prices. To date, however, no academic discussion seems to have been sparked on the subject. Tele2 finds that fact, as well as the lack of comprehensive studies regarding other material questions, unsatisfactory. For this reason Tele2 has found it extremely difficult to answer many of the questions that are posed in the consultation. Therefore Tele2 will focus on commenting on the overall issues in the public consultation.

Tele2 notes that in examining differences between incumbent and entrant termination rates, the ERG consultation appears to focus on the desired result (symmetry) rather than applying principles of cost-orientation and incentivising investment in a consistent and non-discriminatory way.

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 be 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 the ability to fully recover costs while denying others the same possibility.

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 where it is justified by an alignment of underlying relevant (efficient) costs. The circumstances that need to be considered are:

- Time of entry and entry-related costs
- Market situation
- Technological differences
- Risks
- Economies of scale
- Efficiency

Fixed markets

Incumbent fixed network operators have been allowed to recover costs for network build-out in the initial phase through retail prices in a monopoly regime and post-liberalization via high interconnection charges that have allowed them to in most cases fully recover their costs. In essence a fair amount of the access networks have to a large extent been depreciated.

Incumbents' current termination rates thus represent the cost of an operator with a very high penetration rate and market share and high call volumes (economies of scale) and which has completed its network roll-out. Assuming this level of termination rates for later 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. Tele2 therefore disagrees that *"symmetric TRs contribute to enhance static economic efficiency (limiting allocative and productive efficiencies), investment and innovation and finally global welfare…*[1]*"* – at least during the entry and expansion phases in fixed markets. The statement does not seem to consider the peculiarities of the communications industry characterized by high level of sunk costs and therefore significant impact of economies of scale. Operators entering the fixed telecommunications market are faced with high capital expenditures, limited revenue streams and fierce competition (especially from incumbent operators) which in many cases does not allow them to recover their costs only via retail prices to consumers.

Later entrants in the fixed markets are 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). Imposing in these circumstance the same rates as those 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 to counteract the main objectives of the EG Directives. It would not be a proportionate remedy and it would represent a clear disincentive to investment and promotion of competition, pushing operators away from an infrastructure-based competition model versus the adoption of a resale-based competition model buying wholesale services from the incumbent. Entrants in fixed markets face greater costs and risks than the incumbent 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 acquired by incumbents) or accessing unbundled local loops to offer services to customers. An exception to this could be new entrants that do not invest in new infrastructure but still receive fixed terminating traffic, for instance pure VoIP operators. In such exceptional cases, symmetric prices could be reasonable, without any transitional period, as these operators have no real investment that can justify a higher terminating price.

If competitors in the fixed markets are allowed to recover their costs (that are deemed necessary to provide economically effective services) also via termination rates and to invest and achieve market shares, it is inevitable that termination rates will decrease and so will the impact of termination rates on the market whilst the presence of infrastructure based competition will bring benefits to consumers in the longer run.

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With regards to the translation in higher prices for calling the alternative fixed networks, the focus should not be on the nominal values of the termination rates but rather on the overall amount which determines the impact on the retail market. Since market shares of alternative operators in the fixed markets are limited, the overall impact of asymmetric termination rates will be limited, if not negligible.

In the end, when symmetric FTR´s are motivated due to the fact that there is an effective equivalence of circumstances and a justification of symmetry by an alignment of underlying costs, it is not necessarily fair to take the incumbents (cost oriented) FTR price cap as the benchmark for the symmetric price. In many cases there are uneven traffic patterns between incumbents and alternative operators, leading to a situation where alternative operators are net payers to the incumbent. If symmetry is motivated the prices should therefore be set to a level that is in the alternative operators best interest, rather than what is in the incumbents best interest. As an additional advantage this may very well lead to a further reduction of FTR rates.

In summary Tele2 agrees that symmetry in fixed markets could 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 includes the calls market. Evidence in fixed markets suggests that it can take a long period of time for even a strong entrant to match the incumbent's position in these markets, and that this period substantially exceeds that taken in most mobile 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. In an environment for example in which rights of way, number portability and unbundling have been inadequately addressed or in which the incumbent is able to discriminate to limit the expansion of competitors, the 'reasonable' period for reaching symmetry would probably be extensive.

A transition period (glide path) 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 shares) and could also be affected by exogenous factors that affect the ability for an entrant to compete with the dominant player. Each regulator should determine the glide path according to national circumstances based on reasonable projections of the initial status of competition and market developments.

Mobile markets

A major difference between the fixed line markets and the mobile markets within the European Union is that in the mobile markets there are no true legacy networks from which one incumbent operator in a given market can benefit in market shares etc., in some cases, at the cost of other operators who have entered the market later. Instead, in most countries two or more licenses were awarded for GSM-traffic and two or more licenses were awarded for UMTS-traffic. These facts have led to a situation where, in each country where liberalization was introduced before or around 1998, mobile operators have built up networks and provided services to end users in true competition. In general the cost for building the networks in a specific country has been quite similar due to the fact that it, as far as Tele2 is informed, in all countries has been a question of providing services on national licenses. The differences in cost between operators can generally be attributed to different business strategies (such as wanting to provide coverage in rural areas beyond any mandatory license conditions, higher or more attractive bids in auctions and beauty contests), differences in awarded frequencies for providing services and differences in network architecture and the cost of obtaining venture capital.

Since a majority of the mobile operators in Europe have had ample time to build up customer bases in their respective networks, and thus achieve economies of scale and scope the original differences in cost have leveled out. For this reason Tele2 is of the view that symmetrical termination prices can indeed be envisaged as a general rule.

Tele2 is of the general view that symmetry in mobile market termination rates may become a reality on the basis that the advantages between established operators on a market and a new entrant to that market diminish over time.

NRAs should adopt any measure on all operators to ensure 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 reasonable costs including an adequate rate of return. Thus, MTR's should for new operators entering a market as a starting point be based on actual network costs. Tele2 therefore is of the opinion that asymmetric MTR-tariffs for a transitory period may be justified by any objective differences which cause the costs of operators to exceed others due to factors outside their control.

Tele2 is of the opinion that a transition period (glide path) is essential also in the mobile markets 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 shares) and could also be affected by exogenous factors that affect the ability for an entrant to compete with earlier entrant operators. Each regulator should determine the glide path according to national circumstances based on reasonable projections of the initial status of competition and market developments.

The question of how the symmetric price level should be calculated, which factors that should be regarded, needs to be penetrated further in an assessment by the ERG. As a starting point for such an assessment Tele2 would like to point out that a harmonized approach as to how a costing model such as LRIC should be constructed. It is noteworthy that even though LRIC has been named the preferred method to use together with the remedy of cost orientation in a number of Member States the approaches and the actual substance of the LRIC based models differ to such a degree that it may not be possible to talk about the same type of model.

The question of how FTR and MTR are calculated is a key issue for any network operator and thus also for Tele2. For this reason Tele2 is more than willing to participate in any further discussions that the ERG may want to have or to answer any questions that may arise in this context.

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