Mobile Termination Rates

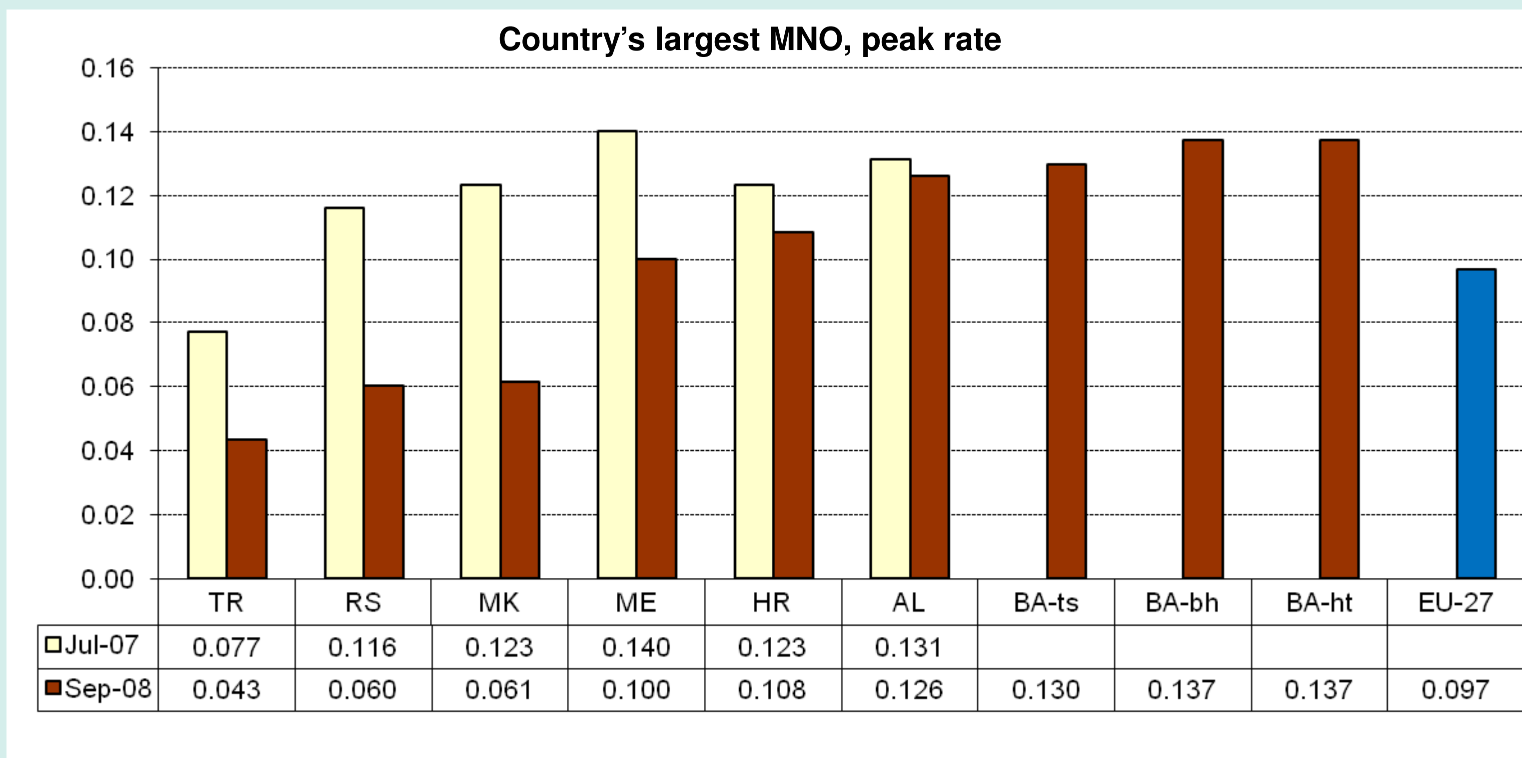
Regulatory challenges

Belgrade, December 17, 2008

Veronica Bocarova
Cullen International
veronica@cullen-international.com

MTRs in SEE: 2007 - 2008

Euro/min



	TR	RS	MK	ME	HR	AL	BA-ts	BA-bh	BA-ht	EU-27
Jul-07	0.077	0.116	0.123	0.140	0.123	0.131				
Sep-08	0.043	0.060	0.061	0.100	0.108	0.126	0.130	0.137	0.137	0.097

Spectrum assignments in SEE

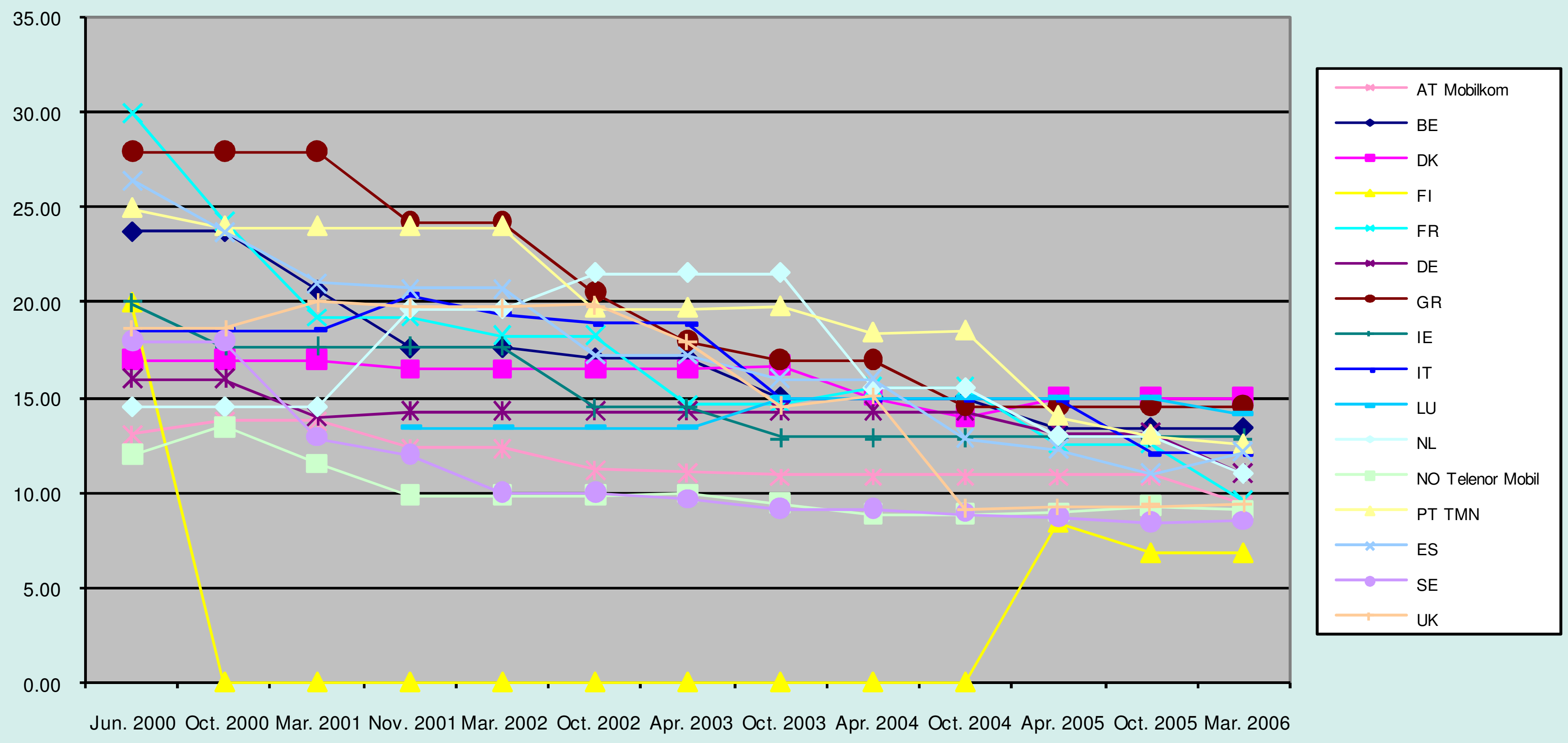
	Mobile network operators				
	UMTS only	GSM/UMTS	GSM only	Other	Total
HR	-	3	-	-	3
MK	-	2	1	-	3
TR	-	3	-	-	3
AL	-	-	3	-	3
BA	-	-	3	-	3
ME	-	3	-	-	3
RS	-	3	-	-	3

HR: T-Mobile,Tele2 – 900/1800 MHz, VIPnet – 900 MHz,

MK: T-Mobile, Cosmofon – 900 MHz, VIP – 900/1800 MHz

TR: Turkcell, Vodafone – 900 MHz, Avea – 1800 MHz

MTRs in EU-15: 2000 - 2006



Market definition and SMP designation

- Market definition
  - Voice call termination on individual mobile networks
  - SMS termination
- SMP designation
  - All mobile operators

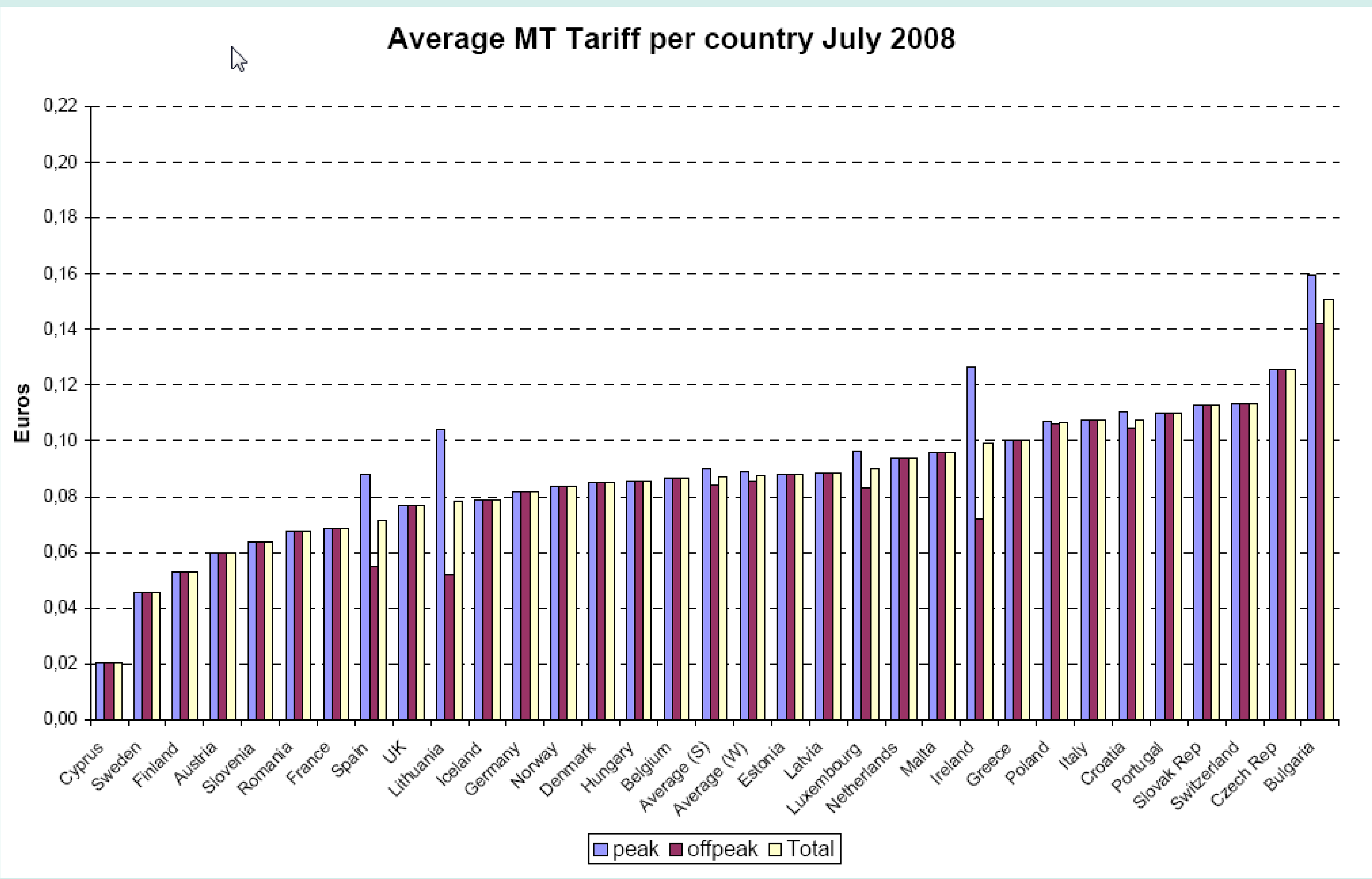
Remedies

- ➔ Regulatory obligations imposed on mobile operators
- ➔ Articles 9 – 13, Access Directive provide a “menu” of 5 possible obligations:
  - ➔ Transparency
  - ➔ Non-discrimination
  - ➔ Accounting separation
  - ➔ Access to and use of specific network facilities
  - ➔ Price control and cost accounting obligations

Focus on price control

- ➔ Glide path
- ➔ Benchmarking vs cost orientation
- ➔ FAC vs LRIC
- ➔ Symmetry vs asymmetry

ERG snapshot – July 2008



MTRs: Outcome of M16 analyses

in Eurocents/min

19
17
15
13
11
9
7
5

Jan. 2006, Apr. 2006, May 2006, July 2006, Oct. 2006, Jan. 2007, May 2007, July 2007, Sep. 2007, Jan. 2008, April 2008, May 2008, July 2008, Oct. 2008, Jan. 2009, Apr. 2009, July 2009, Oct. 2009, Jan. 2010, June 2010, July 2010, Dec. 2010

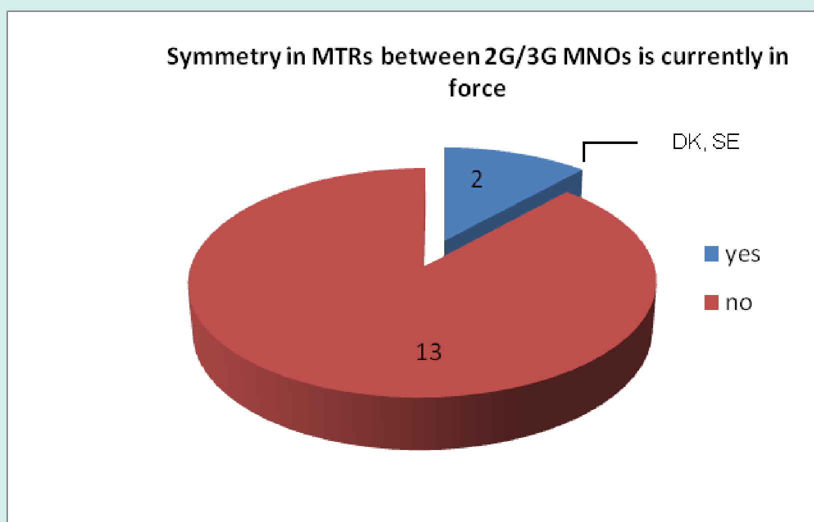
- FR - Orange & SFR
- FR - Bouygues
- IT - TIM & Vodafone
- IT - H3G
- IT - Wind
- PT - TMN & Vodafone
- PT - OPTIMUS
- SE - Telia, Tele2, Vodafone
- SE - Hi3G, Telenor
- UK - 900-1800
- UK - 1800
- AT - Mobilkom
- AT - T-Mobile
- AT - One
- AT - H3G
- DK - TDC, Sonofon, TeliaSonera
- NO - Telenor
- NO - Netcom
- ES - Telefonica
- ES - Vodafone
- ES - Amena
- NL - KPN, Vodafone, Telfort, Tele2
- NL - Orange, T-Mobile
- BE - Proximus
- BE - Mobistar
- BE - Base

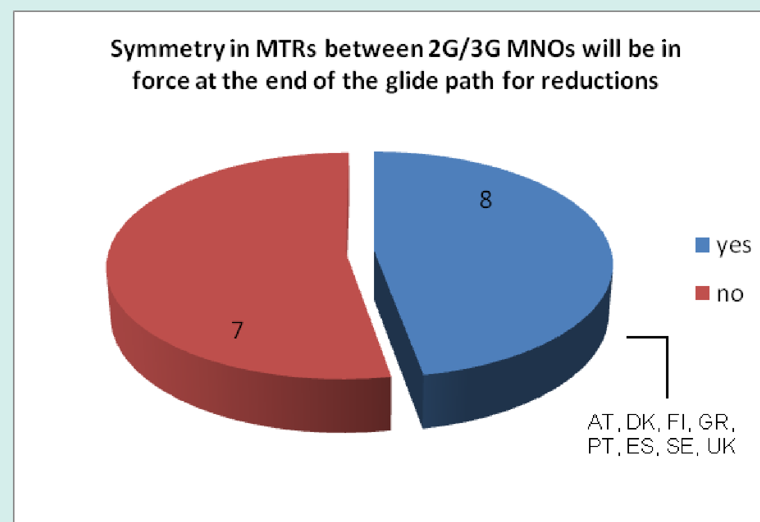
Differentials between MTRs

- ➔ First entrants vs. late entrants
  - ➔ 900 MHz vs. 1800 MHz
- ➔ Among 2G/3G operators (pure 3G not considered)
- ➔ 2G/3G vs 3G only

Differentials between MTRs

- ➔ Today: asymmetry in 13 of the EU-15 Member States
- ➔ By end of glide path period: asymmetry in 9 out of 15





Commission DRAFT recommendation (1)

- ➔ Issued in July 2008 – consultation ended Sept 2008
- ➔ Revised proposal presented on Dec 10, 2008
  - ➔ Consultation until mid-January 2009
- ➔ Adoption scheduled for 2009
- ➔ MTRs should be symmetric and based on costs incurred by an efficient operator

Commission DRAFT recommendation (2)

Cost methodology

➔ efficient costs for termination services to be based on:

- ➔ current costs
- ➔ the use of a bottom-up model
- ➔ using long run incremental costs (LRIC)

Commission DRAFT recommendation (3)

Traffic-related costs

- ➔ Only traffic-related costs allocated to voice call termination services to be taken into account
- ➔ Residual traffic-related costs, once traffic-related costs for call origination, data services, IPTV, SMS or MMS – excluded

Commission DRAFT recommendation (4)

Traffic-related costs

- ➔ Additional network costs linked to capacity increases (and the level of traffic) to the extent that they are caused by the provision of wholesale voice call termination services
- ➔ costs of acquiring additional spectrum to increase capacity (above the minimum necessary to provide retail services to subscribers) to carry additional voice call termination traffic

Commission DRAFT recommendation (5)

NON-traffic-related costs (and therefore excluded)

➔ handset or SIM cards (retail commercial costs), which are not traffic related.

NB. Commission has strong doubts on the inclusion of any externality mark-up above costs as this could be used by MNOs to subsidise the addition of subscribers to their networks

➔ coverage obligations, like costs of site preparation, base station and first transceiver.

Commission DRAFT recommendation (6)

Efficient scale!!!

- ➔ To determine the efficient scale for the purposes of the cost model, the recommended approach is set at 15% market share (*initially, 1/number of MNOs*)
- ➔ It may be expected that mobile operators, having entered the market, would strive to maximise efficiency and revenues and thus be in a position to achieve a minimum market share of 15%

Commission DRAFT recommendation (7)

New entrants

- ➔ New entrants may be subject to higher unit costs for a transitional period before having reached the minimum efficient scale
- ➔ NRAs might allow them to recoup their higher incremental costs compared to those of a modelled operator for a transitional period of up to 4 years

Cullen INTERNATIONAL

Commission DRAFT recommendation (7)

Grounds for asymmetric termination rates

➔ Any determination of efficient cost levels which deviates from the principles set out above should be justified by objective cost differences which are outside the control of the operators concerned

Commission DRAFT recommendation (8)

Implementation in Member States

- ➔ NRAs must implement of cost-efficient, symmetric voice termination charges by February 1, 2012
- ➔ If NRA fails to implement the recommended model because of lack of resources, an interim approach can be applied until February 1, 2012

ERG common response

- ➔ Principles, not fine details of regulatory approach
- ➔ Flexibility for NRAs to choose
  - ➔ Top-down or bottom-up LRIC
  - ➔ Allow recovery of appropriate fixed costs
- ➔ Use of 'best practice' approach as approximation of efficient price level (useful for small countries)
- ➔ Symmetry already addressed in ERG common position
- ➔ Other approaches (Bill&Keep)

ERG on symmetry of MTRs (1)

MTRs should normally be symmetric and asymmetry, acceptable in some cases, requires justification by objective cost differences which are <u>outside the control of the operators concerned</u>:

- ➔ differentiated conditions of spectrum assignment (1800 MHz instead of 900 MHz, resulting in higher costs for good indoor coverage)
- ➔ costs of licences when they are not granted at market prices (i.e. pure beauty contest)
- ➔ late market entry of a new entrant leading to the lack of scale to compete with the other (incumbent) MNOs.

ERG on symmetry of MTRs (2)

Differentiation allowed for a transitory period only

➔ different frequency assignments can justify asymmetric rates as long as

- ➔ they result in cost differences, or
- ➔ until a fully functioning spectrum trading market or regulatory action aligns the spectrum assignments

ERG on symmetry of MTRs (3)

Late market entry can justify asymmetric rates

- ➔ the date of entry on the market
- ➔ the maturity of the market
- ➔ the churn rate
- ➔ the rate of customer acquisition (new contracts)
- ➔ the level of competition in the market (number of players)

Cullen INTERNATIONAL

ERG on symmetry of MTRs (4)

On-net/off-net price differentials

Cumulative circumstances for transitory asymmetry

- ➔ high traffic imbalances and thus important interconnection financial imbalances, as a result of operators' strategies (high differentials between on-net/off-net prices).
- ➔ MTRs are significantly above costs.
- ➔ The NRA considers that benefits of setting transitory asymmetric termination rates (such as potential increases in retail competition) outweigh any short term disadvantages of doing so.

Recent draft decisions on MTRs

- France
  - Orange & SFR: 3 eurocents from July 2010
  - Bouygues Tel: 4 eurocents from July 2010
- Italy
  - TIM, Vodafone, Wind: 5.9 eurocents from July 2011
  - H3G : 7 eurocents from July 2011
- Spain
  - Telefonica Moviles: 7.83 eurocents from Oct. 2008
  - Vodafone: 7.87 eurocents from Oct. 2008
  - Orange: 8.03 eurocents from Oct. 2008
  - Xfera: 11.73 eurocents from Oct. 2008

TELECOMMUNICATIONS & ELECTRONIC COMMERCE REGULATORY SUPPORT SERVICES

IP and interconnection

- ➔ Which economic model?
  - ➔ Calling Party Pays (PSTN model)
  - ➔ Bill and Keep (BAK) ‘The Internet model’
- ➔ Calling Party Pays means no prospects of regulatory forbearance
- ➔ Pressure from regulators to move to BAK
- ➔ Most operators are opposing it

IP and interconnection

- ➔ Fear amongst operators that cost recovery would not be possible as end-users would not accept Receiving Party Pays regime
- ➔ Deterrent to investment: incentive for originating operators to handover traffic for termination as close as possible to origination (‘hot potato’ issue)
- ➔ CPP is, in some cases necessary, to ensure QoS
- ➔ I/C should be based on perceived value of message
  - ➔ Sending an email of high importance vs
  - ➔ Downloading data of high importance

Mark ups for network externalities

- Who is in favour?
  - Belgium
  - Greece
  - Italy
  - Sweden
  - UK
- Who is against?
  - Austria
  - France
  - Netherlands
  - Norway
  - Portugal

MTRs and 3G auction (1)

- UK 3G auctions (2000): £22bn (€36bn)
  - €6bn - €9bn per operator
- Ofcom decision on MTRs (March 27, 2007)
- Contribution to 3G frequency fee
  (based on draft decision notified to Commission (Art. 7) in Sept 2006)
  - around 1.1ppm (1.7 eurocents) in 2010/11 for the 2G/3G operators: mark up of 26%
  - around 1.9ppm (2.9 eurocents) in 2010/11 for the 3G-only operator: mark up of 46%

NB. Ofcom used 5 different scenarios to estimate the value of 3G spectrum. Following Commission comments, in its final decision, Ofcom reduced the contribution to 3G frequency fees (precise value not published).

MTRs and 3G auction (2)

- French 3G licence fee:
  - €619m per operator + 1% of turnover
- Without a licence fee, the cost of mobile termination for a generic mobile operator would be 5% lower

  (ARCEP bottom up model - 2007)

Arcep bottom up analysis – findings (1)

- ➔ Impact of market share
  - ➔ Operator A has 33% market share
  - ➔ Operator B has 20% market share
  - ➔ So B has 39% less market share than B
  - ➔ But only 22% less cost!

Arcep bottom up analysis – findings (2)

- ➔ Impact of cost of capital
  - ➔ If cost of capital went up by 10%
  - ➔ Cost of mobile termination would go up by 2%

Arcep bottom up analysis – findings (3)

- Impact of user consumption growth
- Scenario 1: high growth
  - If user consumption increased by 5% per year
  - cost of termination would fall by 9% by 2010
- Scenario 2: no growth
  - If user consumption increased by 0% per year
  - cost of termination would go up by 2% by 2010