

Response

BITKOM response to the European Commission's Public consultation on termination rates

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The German Association for Information Technology, Telecommunications and New Media (BITKOM) represents more than 1,100 companies. Its 900 direct members generate a sales volume of 135 billion euros annually and employ 700,000 people. They include providers of software, IT and telecommunication services, manufacturers of hardware and consumer electronics as well as digital media businesses. BITKOM is working, in particular, to improve the regulatory framework in Germany, for modernization of the education system and for an economic policy which encourages innovation.

The European Commission has initiated a debate on the future regulatory treatment of fixed-network termination rates (FTR) and mobile termination rates (MTR). The discussion concerns the reduction of both FTR and MTR within the space of a few years to a level significantly lower than at present. According to the arguments of the proponents, these wholesale charges should be reduced with the ultimate intention of creating the potential for reduction of the prices charged to the end customers for a call into another network. In addition, reduction of the price level is associated with the hope of improved market penetration and increasing use.

For telecommunications companies, which supply and demand comprehensive terminations services in mobile telephony and/or in the fixed-net segment, this topic is of central importance. But it must also be emphasised that its significance in business policy is not confined to individual telecommunications companies but can be reflected over the ICT market as a whole in Germany and Europe. Telecommunications companies, manufacturers and end customers are closely interconnected in the market. The risks of a regulation of termination charges will necessarily also have consequences in the form of secondary effects for up- and downstream markets.

The proposal for a recommendation in accordance with Article 19 of the regulatory framework is essentially intended to modify the existing approach for determining cost-oriented charges. The up-to-now generally applied principle of fully-allocated cost charging is to be replaced by charging only the avoidable costs, that is the costs additionally arising through the increment under consideration. It will accordingly no longer be possible to take into account costs arising jointly through the provision of various services in charging for terminating calls. This should apply equally to fixed-net and mobile termination.

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The current debate fails to recognise the complexity of this issue, in as much as it one-sided concentrates on the supposed advantages of this regulatory intervention and is in danger of ignoring its feedback effects. For this purpose the following part deals with the central aspects and risks to be identified in connection with the regulatory treatment of FTR and MTR.

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Central aspects and risks in connection with the future regulation of FTR and MTR

It should first be observed that the markets today already act in accordance with the goals associated with this regulatory intervention, of encouraging competition among operators and reducing prices to end customers. The fixed-net and mobile telephony markets are already characterised by continuously falling termination rates. In the fixed-net segment average termination charges in the EU now lie between 0.6 and 1.2 cents per minute. Surcharges are added as necessary, where termination in competitors' networks is involved. In the mobile area, the European MTR have on average almost halved in the last four years and were in January 2008 at an average of around 8.5 cents per minute. This is reflected further at the end customer level: for example, according to the OECD the end customer prices for mobile telephony services fell on the European average by 13% a year in the period 2004-06 alone. Customer turnover rates ("churn") in mobile services are at over 20%, with the trend increasing. Not least, end consumers in both the fixed network and in mobile can choose from a large number of offers from numerous alternative network operators, service providers and "discounters". This alone already justifies fundamental scepticism over the necessity and propriety of the intended, in our view, elemental, regulatory intervention.

Status quo of regulation

In our opinion it is not understood that the termination markets are already subject to comprehensive regulatory control in the individual member states. A glance at the past decisions of the national regulatory authorities shows: since the end of 2003, for example for termination in fixed and mobile networks over 100 market analysis proceedings of the national regulatory authorities were reported to the EU Commission. Underlying this is at least an equally large number of concrete decisions on charges by which the national regulatory authorities in each case have carried out detailed analyses of efficient costs. The demand for additional rules specifically created for the regulation of termination services is excessive intervention and will involve high direct costs in implementation for regulators and the companies subject to regulation. In the circumstances, there is no indication why the necessity should arise for additional regulation with far reaching detailed requirements prescribed from the EU level.

The national authorities naturally always have an information advantage with regard to national termination markets and already have the responsibility to take adequate account of these in their decisions. Recourse to knowledge of the specific characteristics of the respective national markets should therefore already enable adequately to ensure that there is sufficient regard for the notion of a unified EU-wide regulation but without neglecting country-specific structures which are relevant to costs. For example, differences in population size and concentration, surface area, topography, traffic volumes, service qualities, license costs, wages, tax rates, legal frameworks, etc. could justify different levels of termination rates.

To illustrate just one aspect, the payments made for UMTS licenses on a per-capita basis are at least three times as high in Germany and Great Britain as in other countries. In addition, the national regulatory authorities are already encouraged to ensure uniformity of regulatory practice and the uniform application of requirements. Harmonisation reaches its limits in prescribing a common regulatory framework and is not to be equated with identical charges in all member states.

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In other words, the regulatory intervention intended is inappropriate since it ignores the fact that markets today are already competitively structured. Additional regulation is not necessary because the markets for termination are already comprehensively regulated by the national authorities. EU-wide harmonised regulation furthermore does not mean identical charges in all member states.

Fixed and mobile – necessity to distinguish

Not only do termination markets differ between the EU member states. Regard must also be taken of the differences existing between the fixed network and the mobile sector, which mean they must also fundamentally be considered separately from each other. The differences are to be seen, for example, in the area of network- and cost structure. In addition, mobile networks, unlike the traditional fixed network, were developed directly in a competitive environment. It must also not be neglected that a participant in the mobile network can be reached independently of his actual location.

Requirements for fair and appropriate termination rates

The level of the regulated termination rates must allow the operator at least to cover all the costs incurred in carrying out the termination service. It is the usual and accepted practice that this is achieved by a fair calculation of costs according to the input involved. On this basis all network costs are included in termination rates (switching exchanges, transmission routes, masts and infrastructure, licenses etc.) to the extent that they are used by the termination service. The same also applies for costs which arise in connection with the operation and maintenance of the network (personnel-, energy- and rental costs etc.). To these are added further costs from the areas of distribution, marketing, invoicing, administration etc. Overheads not directly attributable to the minutes of the individual termination, to which costs for middle and higher management must also be added, are consequently not to be neglected but have to be charged on a pro-rata basis.

Ignoring overheads in determining termination charges in a network operation based on fixed costs means blending out significant cost pools. Network operators – in fixed-net and mobile alike – will thereby consciously and intentionally forced to offer their services far below the actually accruing costs. This creates the impression the provision and use of telecommunications infrastructure is a free good.

Every departure from the principle of fair calculation of costs according to the input involved creates distortion and can encourage cross-subsidisation. This in turn could lead to unfair discrimination between individual services or customers. It is the goal formulated by the EU Commission itself to avoid this kind of unfair discrimination. If substantial contributions to covering costs drop out at the level of prepayment, these must accordingly be met through higher prices to end customers. The fact is that, through failure to acknowledge their expenses, operators could be compelled to compensate for the failure to cover costs through upward price adjustments in the retail sector.

In this respect the proposed reduction of termination charges works against the prevailing and from all sides accepted as fair distribution of costs between the network operator, the caller and the called. Whenever a participant in a telecommunication network calls a respondent in another network, a service offering of the provider of the

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called network is required for communication – the termination. The regulation envisaged would from now on mean that the network operator of the call recipient would be unable to pass on 80-90% of the costs for incoming calls and so would have to bear them himself. There is neither any obvious practical reason for this result nor are the repercussions to be expected for the end customer market convincing: when incoming calls do not sufficiently contribute to cost-recovery various costs would have to be recovered via outgoing calls, subscription charges or RPP (Receiving Party Pays) elements. That has repercussions above all for the low users among mobile telephone customers who seldom make calls themselves but mainly want to be accessible.

The last-mentioned aspect in particular is liable to endanger the offering of the, for particular groups of customers (low incomes and young people) very attractive pre-paid tariff models, since “free” accessibility would no longer be tenable and the end customer would ultimately have to pay for received calls. Such a development would ultimately lead to a deepening of the digital divide. With this the outcome is to be feared that end customer prices will increase and penetration of mobile telephones will decrease.

The proposals of Commissioner Reding are similar to the mobile telephone regime of the USA. There the monthly prices for mobile telephone use amount to at least \$ 20, approx. € 15. This is considerably more than in Europe. Research shows that more than 20% of European mobile network customers today lie below this price level. These customers then either have the choice to pay more or they will simply leave the market. This applies to around 100 million mobile network customers in Europe. Market research investigations show that an increase of the monthly mobile telephone charges of only € 1.50 in the EU would lead to an average reduction in the mobile penetration of around 23%.

Against this background the specification of termination charges have to be carefully balanced. The combination of a too early ruling and too low termination fees otherwise threatens to have a lasting negative effect on the business model and can be disruptive.

This also applies to the development of new, more modern network structures. The implementation of innovations can always only take place within the bounds of technical and economic capacities. Telecommunications networks develop in stages; new technologies are mostly introduced successively. This necessarily creates a certain path-dependency. The transition to Next Generation Networks, for example, is a process which requires far-reaching planning and corresponding time to be established. This also means that technologies to be relinquished are typically operated for a while in parallel. This is the only way a harmonious transition can be assured to the use of the next technological generations. Existing circuit-switched core networks in the fixed network and mobile area alike are no exception.

Technical restrictions are complemented by the conditions of the economic environment: if it is not possible for providers to yield sufficient revenues which compensate for a cut in termination rates, perhaps because the market price level does not increase by the same amount, a deficit in marginal income arises. This deficit must then be borne by the company itself and will be a serious burden on those mobile network providers which have no further reserves of profitability. The consequences will directly affect smaller providers which are operating as third or fourth providers in the market. Some of these providers will probably not survive this.

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Even if all technical restrictions for a migration to the new technology have been overcome, a too early and too strict regulatory performance specification would mean that network operators are virtually forced into ad-hoc migration. In the extreme case existing installations will be devalued in the process, which leads to an increased and regulation-induced amortisation. This is associated with considerable inbuilt risks: typically regulators argue in their decisions that it is not possible to take into account migration costs in the course of a change in technology (e.g. depreciation and dismantling of circuit switched technology) as they should already have been written off in the past (from the NGN viewpoint, that is now). However, current regulation is apparently putting paid to this with continuing reductions in charges, so that a complete amortisation of the investment made is no longer possible.

As described earlier, the stage of technological development and other structural variations (e.g. differences in costs for licenses) of the individual networks thus play a central role. Clearly, uniform transition periods prescribed for all member states are not able to make allowance for this fact. The national regulatory authorities should be free to extend the transition period. Against this background, glide paths should not be shorter than 7 years.

Conclusions

Complex systems for modelling costs already exist today, both at national level and among regulators, which find widespread application in regulatory practice. There is no need for an additional cost accounting system exclusively for termination charges and to be implemented in every EU country.

In so far as the level of FTR and MTR should be determined according to the results of an international comparison of prices, it must be pointed out that this is a complex task and by no means trivial. Clearly, taking a simple average of the lowest tariffs is neither sufficient nor adequate. It is important to notice that there can be fundamental differences between countries regarding population size and concentration, size of the territory, wage level, taxes, topography, network traffic demand, quality of service (e.g. wireless coverage inside buildings) or also spectrum costs. Adequate degrees of freedom must accordingly be granted at national level to be able to take account of these specific features of particular countries and markets. Otherwise countries will be compared with each another which simply have no structural similarities.

Regulation of FTR and MTR involves considerable risks. Setting the wrong course even in individual points can bring with it lasting negative effects for the regulated companies. The effects are not confined to a static view. On the contrary, particularly in the dynamic context special care has to be taken not to place burdens on the climate of investment and innovation in Europe.

This in turn not only has direct implications for the regulated network operator. In this connection, risks are also particularly to be feared in the form of negative secondary effects in upstream and downstream markets. This applies not only – as already mentioned above – to end customers with prepaid products, but also with regard to manufacturers marketing fittings and equipment for new technologies. Ultimately this can also lead to long-lasting negative effects for the whole ICT industry in Europe.

This all stands in diametric opposition to the declared goals of Commissioner Reding: Consumers will be put in a worse position, the number of companies reduced and competition reduced. All those involved will consequently be disadvantaged. In addition, investment incentives will be severely reduced, if companies are denied an adequate refinancing of infrastructural investments and telecommunications networks are

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seen as “free”. Effects on efficiency are also completely ignored. The economically efficient allocation rule for fixed costs and overheads (Ramsey Pricing) is stood on its head, whereby costs are relocated to where the demand elasticity potentially is greatest. The corresponding avoidance effects result in the reduction of mobile penetration described above.

These implications also demonstrate that the draft recommendation is inconsistent with the telecommunications legal framework. Application of the recommendation would infringe the basic principle of Art.13 of the Access Directive, according to which it is to be ensured that mechanisms for cost recovery and tariff systems encourage economic efficiency and sustainable competition and are to the best advantage of the consumer.

Reference to a statement of Commissioner Reding may be permitted here, according to which “the enormous gap between fixed network and mobile telephone charges” is a “serious impediment to the completion of the European internal market”. Leaving aside here whether this statement is correct, BITKOM is of the opinion – as already demonstrated above – that fixed and mobile networks differ in relevant aspects, which not only justifies a different treatment of FTR and MTR, but also makes this necessary. To this extent, there are solid grounds which, at least for the present point in time, require that things which are essentially different are treated differently. In addition, the approach proposed by the Commission lead both in the area of FTR and in MTR alone to an absolute reduction in the level of remuneration. No comment will be made on the relationship between FTR and MTR, in particular the question of the supposed gap between them.

The mobile telephony model of the USA is not a suitable example to follow. Adopting the Commission's proposal based on the mobile regime there would lead to significantly higher prices for end customers and a much lower mobile penetration level. This would affect around 100 million mobile telephone customers in Europe.

A “rebalancing” between fixed-net and mobile – for which there is also no necessity – will not be brought about by the proposed change. On the contrary, fixed and mobile network providers will be committed to offering services at a loss. Only a few individual suppliers could profit by chance through their specific structure of calls. In principle, however, all would be worse off.

There is also nothing at all out of balance in Germany regarding the determination of remuneration between mobile telephony and fixed-net. With the costs of efficient service provision, a uniform criterion for approval of charges is already prescribed by law. Differences in the level of charges cannot therefore be related to a different criterion for approval.

The control regime in operation is also appropriate to achieve the goals formulated by Commission Reding – consumer protection and encouraging competition. Today it already prohibits realisation of profits in forwarding calls and enables fair competition through discrimination-free access to infrastructure. At the same time the effects of the rules in operation also represent the ultimate extent of what companies can sustain economically. Compulsion to offer services way below the costs resulting from their provision is not economically possible and threatens the ability of the provider to survive.

Finally the point must be made that the regulatory policy decision over future treatment of FTR and MTR must not be taken without regard to the side-effects and manifold risks with which it is associated. Potential feedback effects must receive adequate

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consideration, not only from a static but also above all from a dynamic point of view. This demands analyses in advance of effects, costs and benefits.

A so-called "impact assessment" of this kind should have the purpose of identifying the various options for achieving the sought-after goal and to analyse them in a comprehensive and balanced way with regard to their effects on the economic and social environment. This should include highlighting the advantages and disadvantages of each option. Without estimation of the consequences there can be no factually based political decision process within the Commission.

Whenever the EU Commission wishes to express a corresponding recommendation, it is therefore indispensable that this is accompanied by an assessment in advance of the consequences, which provides unambiguous and objective, verifiable evidence to validate the appropriateness of the planned regulatory intervention under consideration.