Contribution of France Telecom Group to the ERG public consultation on a draft Common Position on symmetry of mobile/fixed call termination rates

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ERG public consultation on a draft Common Position on symmetry of mobile/fixed call termination rates

Orange/FTGroup answer

Orange/FTGroup welcomes the opportunity given by ERG public consultation to precise its position on symmetry of mobile/fixed call termination rates.

Orange/FTGroup's major messages are the following:

- **Orange/FTGroup** supports symmetry between FTRs and between MTRs in each country, but not between FTRs and MTRs
- **Orange/FTGroup** does not believe in the dynamic benefits of transitory asymmetry and considers on the contrary that allowing asymmetry may irreversibly damage the efficiency of the market. Therefore asymmetric TRs should disappear from regulation as fast as legally feasible.
- **Orange/FTGroup** considers that ERG should produce fully consistent recommandations and cannot support in the same document conflicting regulatory policies. Otherwise ERG would not be seen as an efficient organisation for achieve consistent regulation in Europe. In that respect, the present consultation is not satisfactory as it contains at the same time developments in favour of symmetry and pages trying to justify asymmetry[1].

The arguments supporting these statements are detailed through the answers to ERG's consultation.

General questions

Questions G1-2 :
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?
...
G2: Any further comments …

The principles outlined in the introduction are correct concerning the structural inefficiency which results from asymmetry between fixed termination rates and asymmetry between mobile termination rates[2].

However, developments concerning possible general dynamic efficiency effects of asymmetry are not completely convincing because they ignore certain economic effects. The effects which could have also been included in the general introduction are the following:

[1] Pages 84 - 86 which are inconsistent with the rest of the document.
[2] Discrimatory access to spectrum between mobile operators may explain MTRs asymmetry. This type of asymmetry should be strictly limited to the specific cost impact of discriminatory access to spectrum for an efficient operator and must cured by relevant spectrum refarming. This exception to symmetry will be precised in the mobile section of the answer.

- Generally, the text underestimates the 'addictive' nature of asymmetric termination rates on new entrants' business models. New entrants are encouraged to keep their business model dependent on asymmetry in order to oblige regulators to postpone again and again the time of symmetry. This is even more the case if the regulator has shown in the past to be hesitant and not able apply effectively a glide path towards symmetry. Then the "dynamic benefits" supposed to compensate the static inefficiency of asymmetric termination rate instead become a permanent way to inefficiency, imbalance and reliance on asymmetry. It effectively induces an enduring competitive distortion in the market.

- More specifically, the analysis assumes that traffic imbalance is an exogenous phenomenon, ignoring that it is generally the outcome of asymmetric termination rates: if regulators accept asymmetric termination rates in the case of traffic imbalance, then access operators which benefit from asymmetric termination rates will choose commercial strategies which will generate traffic imbalance. Regulation is then locked into a vicious circle, asymmetric termination rates generating traffic imbalance and vice-versa.

- The text should underline that the very reason which makes the average traffic cost higher in a new entrant's network, i.e. the fact that the network capacity which is dimensioned for target volumes is underutilised, naturally leads to **lower traffic marginal costs for new entrants** than for incumbent operators: an entrant network can accept more extra traffic with less extra capacity. When traffic volumes increase on the operator's network, average costs go down and marginal costs go up and tend to converge for the volumes of the efficient operator, which is dimensioned consistently with traffic demand. Thus new entrants, when earning efficient operator TR, make a higher profit on variable cost than efficient operators. Therefore they have all economic incentives to become an efficient operator with a strong market share as soon as possible, unless their incentives are skewed by an inefficient regulation rewarding artificial and restrictive commercial policies through asymmetric termination rates .

Question G3: Finally we would like to ask you to elaborate on the question of converging MTRs and FTRs and the timeframe you envisage for this.

If the question addresses convergence within each country's FTRs on the one hand and within each country's MTRs on the other hand, **Orange/FTGroup** approves a fast convergence, for the reasons developed above. Symmetry should be obtained as soon as market analysis procedures legally permit .

If the question addresses the issue of convergence between FTRs and MTRs, then the text of the consultation does not correctly explain why the strong rationale in favour of symmetry between fixed termination rates and between mobile termination rates does not apply between fixed and mobile termination rates. FTRs and MTRs are obviously different services both in terms of utility and of production, and therefore there are no reasons to have symmetric prices.

Given that the ERG document nevertheless addresses the topic of "symmetry" between FTR and MTR, in the following, we will set out four reasons why symmetry should not apply between fixed and mobile termination rates:

1) First and foremost, the fact that fixed and mobile termination traffics, which are acknowledged as two different markets in the Commission Recommendation on relevant markets, have different costs.

- The switching and signalling systems of mobile networks are more complex than for fixed networks

- The geography of transmission links needed to carry the traffic from and to the antennas is specific, because antenna locations are generally different from MDF locations, and may be more difficult to reach.

- Fixed and mobile access networks have entirely different characteristics. Both capacity and coverage costs of the mobile access network are traffic sensitive, which is not the case of fixed access network. Capacity costs in mobile access networks are obviously traffic dependant. It is also the case of coverage costs, although this is less straightforward to understand than for capacity: the major effect of mobile coverage is to enhance the utilisation of the mobile service, both incoming and outgoing, by existing mobile subscribers.

2) The value of the termination service for the calling party of a call: asymmetry between fixed termination rates or between mobile termination rates does not correspond to any difference in the value of the service for the retail customer who is the real end user of the termination service. Her/his call will have the same value for her/him whatever the specific fixed (or mobile) operator chosen by the receiving party. But she/he will have to pay the same service a higher price in case of asymmetric termination rate, as her/his own operator will have to cover one way or another the extra cost due to asymmetric termination rates. On the contrary, there is a strong difference for the calling party in the value of the service between a call to a fixed party and a call to a mobile party due to the fact that calling a mobile allows to join the receiving party wherever she/he is, which is not the case a fixed telephone is called. Therefore a termination to a mobile and a termination to a fixed are different services in terms of value for the customer. As there is no symmetry in the value for the customer, there is no reason to have symmetry in the price of the service.

3) Termination revenues allow the development of cheap offers targeting new customers, which feed the growth of the market. This form of positive network externality effect allows the mobile industry to use a part of termination revenues to subsidise marginal customers on mobile networks. Corresponding offers target low cost and prepaid subscribers who form the last unpenetrated area of the market. This has a benefit for society as a whole by increasing the total number of people, especially for those of low income users, which has access to electronic communications services. Such development could not happen on fixed networks, where access and carrier selection obligations do not allow mobile like pre-paid offers to emerge. This effect can be observed very clearly on Eastern European markets. Of course, if direct competition between fixed and mobile becomes sufficient, then access obligations on fixed incumbent should disappear and the issue could be reviewed in a new context.

4) Regulators have always assumed that substitution between fixed and mobile services was limited:

- Either this regulatory hypothesis is still true. In that case the continuing growth of mobile subscriptions does not imply an equivalent decrease of the number of fixed lines. On the contrary, it continues to feed the growth of the global market. Under this hypothesis, asymmetry between fixed and mobile termination rates which have a positive impact on mobile subscription, lead to an efficient overall growth of the total electronic communication market. This growth increases the value of communication services for fixed and for mobile subscribers. This principle has led to the extraordinary success of the development of the mobile market. Under the hypothesis of continuing limited fixed-mobile substitution,

asymmetry between FTRs and MTRs is still an effective principle which can continue to help the growth of electronic communications sector and of the European economy as a whole,.

- Or in some countries, the regulatory hypothesis has become false and mobile services have become substitutes of fixed services. In that case, infrastructure based competition is actually in place and fixed incumbent do not have anymore Significant Market Power. Their services may be substituted by corresponding mobile services. Then corresponding access obligations on fixed incumbent should be dismantled and fixed incumbent operator should be given full freedom to compete with mobile operators.

Orange/FTGroup believes that we still experience a limited substitution between fixed and mobile and that therefore MTRs have a strong impact of the overall growth of the electronic communications market.

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

The definition of "converging fixed-mobile market" is not a clear concept. It can refer to both the issue of "mobile operator's entry in fixed telephony market" and of a "fixed operator's entry in a mobile telephony market".

- The first aspect of this entry is direct competition between fixed and mobile operators.
  - **Fixed-mobile substitution has been existing for more than a decade**, at a time when MTRs were much higher, and the difference between fixed and mobile MTRs **has not raised any problem in this context**.
  - If the ERG question raises the issue of **competition between mobile and broadband operators** (providing VoIP services), it should be noted that **the main demand broadband operators are satisfying is … broadband**, which requires investment in technologies and assets rather different than mobile ones. As a matter of fact, both markets have never been analyzed as substitutable.

- The second aspect of the question can related to emerging technologies (such as Homezone) which enable specific mobile devices to connect via a wifi connection. Currently there is no reason to regulate this kind of innovation.
  - In such cases, customers must have both a mobile and a fixed/broadband connection; therefore the fixed-mobile substitution is rather lower than in the previous case.
  - Operators proposing such services are investing in new devices, new technologies (some mobile operators are even simply reusing GSM network with the Cell ID technology), can be both mobile and fixed (with MVNO contracts), using both fixed or mobile numbering resources. Specifically regulating these services would not be a good signal in favour investment and innovation.
  - **Different levels of TRs for fixed and mobile does not prevent at all the development of such offers.** Some customers may even choose the type of number they want to use, depending on the fact that they prefer being called for a "cheap" price or not.
  - However, for the sake of consumer protection, NRAs should take a special care in preventing the use of mobile numbers and MTRs if service provided by operators is not mobile (i.e. the call is always terminated on a fixed location). Indeed, **mobile numbers should only be used if the service delivered is actually to provide a better chance to reach personally the customer**.

Orange/FTGroup does not see any reason why the emergence of convergence offers should lead to a specific regulation of converged TRs
Regulation should impose
- symmetry between fixed termination rates within national markets
- symmetry between mobile termination rates within national markets
- and no symmetry between fixed and mobile termination rates.

Answers to the General questions of the consultation explain the reasoning for an enduring differential between fixed and mobile termination rates.

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

Orange/FTGroup favours the initiative of ERG to establish comparison matrices between European countries to actually measure the level of asymmetry in different countries.
However, we believe the methodology and assumptions for calculating a country "asymmetry index" could be improved, in the following way

Incumbent Termination Rate Reference

As the European relevant market recommendation does not incorporate the transit market any longer, **the incumbent's reference TR should be the local TR**.

However, if single tandem has to be taken as a reference in an asymmetric index calculation, it should only come as a consequence of a transit market analysis. In such a case, the incumbent reference level should rather be a value such as

$$TR.reference = \max\left[LocalTR * \left(1 - \frac{p}{p'}\right) + SingleTandemTR * \left(\frac{p}{p'}\right); LocalTR \right]$$

Where

- LocalTR and SingleTandemTR are the incumbent's termination rates
- p is the proportion of traffic delivered at Single Tandem level or higher
- p' is a reference proportion to establish the fact that the transit market is competitive (eg 30%)

Indeed, if more than 70% of the traffic is delivered at local level, it probably means the transit market is competitive, and single tandem becomes both an irrelevant value to be taken into account and a tariff which may start being regulated in a non excessive (rather than purely cost oriented) way.

In any case, establishing an automatic link between alternate TRs and any transit market tariff should be avoided as it can lead to very inefficient border effects. For instance (delayed) reciprocity favours the TRs of actors which did not invest in network deployment.

OAOs Fixed Termination Rates

For the same reason, Table 10 should probably be revisited : **OAOs cannot have several levels of TRs**. If the transit market is competitive, the TR level is the lowest possible tariff as the relevant interconnection point – therefore, it is not possible to have OAOs with "only single tandem TR" (which however seems to be the majority of cases).

In a country where OAOs have different levels of TRs, it should be possible to compute an average OAO TR depending on the direct access market share of OAOs.

Asymmetry index calculation

Using both the information provided on page 31 and the levels of local and single tandem value provided on page 29 of the EU report, it is then possible to calculate a FTR Asymmetry Index.

$$AssymetryIndex = \frac{OAO.TR - TR.reference}{TR.reference}$$

Obviously ERG is in a much better position than FT/Orange to make such calculation – in particular to take into account potential variations between OAOs TRs inside a given country - and we hope the next version of the ERG document will incorporate such a benchmark.

Direct access benchmark

Collecting information on direct access as a way to measure « how many customers are not served directly by the incumbent allowing, therefore, OAOs to realise termination revenues » is definitely a good way to measure the market effects of an asymmetry policy.

However, **special care should be taken to enforce consistency of NRAs answers for figures related to direct access data** relevant for OAOs termination fees.

For instance, when we compare the figures provided for the United Kingdom

- On figure 1 of the ERG report, the direct access ratio % is 25.5%.
- When calculating this figure based on figure 4.25 of Ofcom's « communication's market 2007 », it seems direct access in UK at the end of 2006 was rather close to 18% (Cable + Other direct + Full LLU).
    - To that extend, it should be noted that **WLR should not be taken into account as part of the direct access ratio, as far as TR are concerned**. In such a case, even though customers have indeed a direct relationship with an alternate operator, the Termination fees are collected by the incumbent operator.

Source: Ofcom / operators

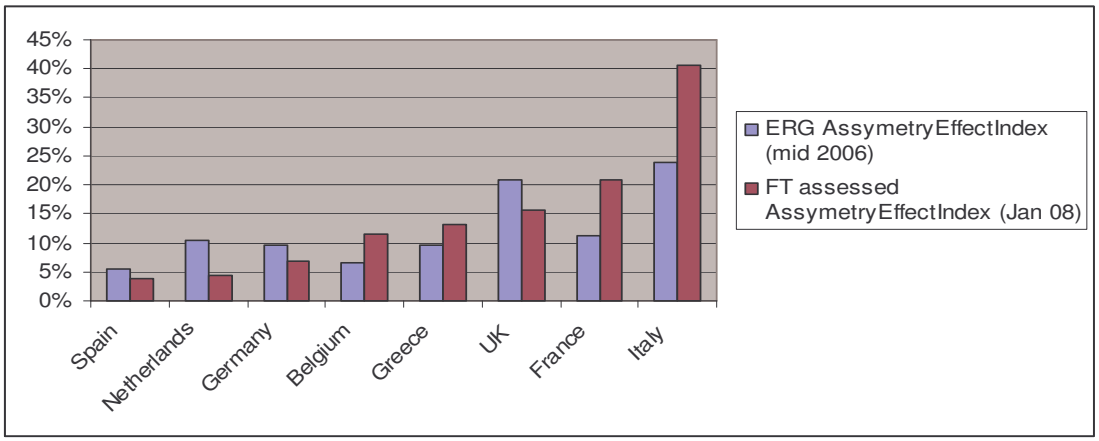
Asymmetry market effects

In order to **properly assess the effects of asymmetry on the actual market**, the FTR asymmetry index should be multiplied by the % of OAO subscribers in direct access - ideally with a dynamic perspective taking into account the growth of alternative local loop on the market.

$$AssymetryMarketEffectRatio = (AssymetryIndex) * (\%DirectAccess)$$

This ratio actually measures the % of fixed TR rise for actors terminating traffic on fixed networks.

The following table represents **Orange/FTGroup**'s assessment of the "asymmetry market effects ratio" based on mid 2006 figures provided by ERG and by figures collected by FT. **Ensuring the consistency of the measurement of such an index** could be a good tool for ERG to measure the actual effects of asymmetry.



Glide path / prospective vision

In order to measure the glide path to symmetry, **Orange/FTGroup** suggests to ERG **also to collect the future evolution of the asymmetry index ratio** defined above over the period 2007-2010.

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?

The list is actually in chapter 6.1.

If question F3 means: Do you think that the reasons mentioned in chapter 6.1. Are good reasons to justify asymmetry?
Then the answer is definitely no.

- It is not true that OAOs have structurally lower economies of scale.
  - Taking into account the strict perimeter of relevant cost for fixed TRs (i.e. without taking into account the access costs), it is not true to state that OAOs have structurally lower economies of scale. Actually, OAOs can rapidly (i.e. with less than 10% market share on access) reach TR production costs that are lower than incumbents'. The main reason being that newcomers are usually selecting dense area, with a "green field" approach in terms of deployment, whereas incumbents have to manage evolutions of much more capillary networks.

- If the justification for asymmetric TR's is to "raise OAOs market share", this means the alternative operator will have invested the benefit of asymmetric FTRs in retail prices. If these results in an actual raise of market share, this policy will have created a competitive distortion and a cycle of dependency whereby the OAO's business model will be reliant on asymmetric rates.

- In a country where broadband and data networks are reasonably developed and drawing down transit costs, OAOs' TR costs are actually lower than incumbents TR. Therefore, adopting a symmetric regulation policy of fixed TR's is perfectly fair as it actually means granting a margin to OAOs.

- Lastly, whilst OAOs may have a lower bargaining power compared to incumbents, OAOs benefit from a tough competition between suppliers and also are in the best position to attract a supplier with a new technology looking to enter on a country or a market.

If question F3 means: Do you think that the arguments mentioned in chapter 6.1. Cover all possible arguments which may be imagined to try to justify asymmetry and that no other argument may be considered?

Then is answer is yes with one exception: networks with a smaller geographical coverage usually benefit from a cost advantage over networks with larger geographical coverage, because they select dense areas. If they were to be cost oriented, Networks serving only dense areas should actually have lower termination rates.

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

Asymmetric fixed termination rates have never been an effective "entry assistance policy". Experience has shown that entrants who become strong competitors and develop sustainable businesses are those which innovate in the way they invest and address the market, and not those which are prisoners of a regulated economic space designed for them by regulators.

Now that the evolution of market structures ten years after market liberalisation has selected real competitors with significant market position, asymmetry is even less than ever an effective policy.

Asymmetric fixed termination rates have never been an effective "entry assistance policy".
A much more effective entry assistance policy on access … is to favour competition on access, through the effective (both in terms of tariffs and process efficiency) development of LLU and access/cable competition

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

As mentioned above, the definition of an "efficient" operator will have to be defined relative to the network geographical coverage. An efficient operator covering only dense zones should have a smaller traffic cost than an efficient operator covering the whole country.

Apart from the coverage issue, the hypothetical efficient operator uses the best technology available, and benefits from unbundling and number portability and produces the same services as the ones available in the real world.

The costs an efficient operator incurs to provide termination services are the costs which have been defined as relevant for interconnection prices since 1998. In particular access costs are not relevant for termination services and must not be taken into account.

Question F6: Do you agree on the fact that OAOs should be as efficient as the incumbent?

The very reason to open the fixed telephone market to competition has been to produce telephony more efficiently thanks to competitive pressure: **if competitors were not supposed to be efficient, then regulators should not have chosen competition as a framework for the telephone industry**.

From a more technical economic point of view, **OAOs were already able to be as efficient as the incumbent** using PSTN technology, due to of the lack of coverage obligation and their possibility to concentrate a lot of traffic on a small surface and a small number of switches.
Now that NGNs are replacing PSTN, OAOs start with structural cost advantages over incumbents. Having less sunk costs on PSTN, they can move sooner and faster to NGN solutions. Economies of scope between telephone and broadband services make any differences in telephone traffic volumes between OAOs and incumbents insignificant for telephone unit cost purposes. And OAO still benefit from more geographically concentrated networks.

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

Yes, the structure and the licensing process of the mobile market are different. Mobile operators need individual licences to operate with access to spectrum. Therefore the conditions of operation may vary individually in relation to the specific characteristics of individual licences. **Under certain limits which are discussed in the mobile part of the consultation (answer to question M2), this may justify transitory difference between individual MTRs.**

By contrast, there is a general authorisation for fixed operators. Therefore there are no objective external differences between fixed operators and therefore no reason to adopt asymmetric tariffs.

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?

Yes because FTR based on incurred cost would not incentive operators to minimise their costs. Inefficient operators with high costs would have their costs paid by the customers of efficient operators.

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

Yes. Termination rates have been a permanent issue of commercial, technical, regulatory disputes for ten years, due to lack of consistent regulation of OAOs FTRs, with high direct costs and high uncertainties. It is time to end this and to focus on actual value for customers and set symmetric Fixed TRs at national level.

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

Yes, otherwise it paves the way to inefficiency in OAOs and distorted competition. Taking into account the fact that asymmetry does exist today, the priority is to define **the fastest possible glide path to symmetry, and to state very clearly that it will be applied firmly without hesitation or renegotiation**. Especially in markets where the OAO market shares are rising fast or have already reached a significant level

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?

Now that regulators have engaged themselves in asymmetric FTRs, it is unfortunately impossible to return immediately to efficient symmetric FTRs. Curing an addiction obviously needs care and time. However the longer this continues the worse the situation will be. So, symmetry for FTRs should reached as fast as legally possible, that is in 2009 at the latest, sooner than the deadline of 2010 fixed by Commissioner Reding in 2006.

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

The most important element will be that NRA should be very clear and firm on the application of symmetric FTRs by 2009.

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 in according to national circumstances?

It is necessary to have at the **European level a time limit to reach generalised symmetric FTRs**. If national circumstances make its possible, NRAs may decide to go faster and reach symmetry before the European time limit.

Mobile Call Termination

Introduction

We support the principle of symmetry of mobile termination rates between operators within a national market. We do so, in pursuing the interests of productive and allocative efficiency in mobile markets, which we believe ultimately leads to the best deal for our consumers. Whilst we recognize that asymmetry persists in some markets, we believe that the best solution is to adhere to reasonable glide paths to achieve a forward looking picture of symmetry. To this extent we support the work of the ERG in defining a European stance on symmetry and the assessment of exogenous cost differences.

We are quite concerned that this principle of symmetry between operators does not become confused with what are two very separate issues, that of:

- Differences between fixed and mobile termination rates
- Consistency of cost modeling approach resulting in different termination rates across national markets

There are key differences between fixed and mobile technologies which explain why mobile termination rates will continue to differ from fixed termination rates. We anticipate that we will have the opportunity at the next stage of the consultation to set out these key differences and to explain the reasons (which we briefly set out in appendix M) why a harmonized cost modeling approach to calculating MTRs would still result in a variety of MTRs across Europe.

In our view, the key focus of the ERG consultation should be on assessing the differences between fixed and mobile and between countries and we hope this will become evident through the work on cost modeling. However, we take this opportunity to outline why we broadly support the principle of symmetry between operators, in answer to the questions M1 – M9.

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

Yes. We support the ERG statement in favour of long term symmetry. In countries where asymmetry is still applied, we welcome a clear statement by the relevant NRA on the rationale and time limit for any asymmetry. It is necessary that full transparency is ensured and that the NRA sets out the time period of asymmetry in their market analysis.

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

Exogenous cost differences have historically warranted asymmetry between operators. The use of one cost model which produces different costs for different operators due to exogenous cost reasons is still in line with the principle of productive and allocative efficiency. Differences in spectrum holdings have been the greatest cause of exogenous cost differences, as GSM 1800 operators typically have a higher unit cost than GSM 900 operators. Asymmetry should be proportionate to the different costs implied by the difference in spectrum allocation. However, with the introduction of spectrum refarming, we expect these

cost differences to be addressed over time. In theory, operators will trade spectrum to the point where spectrum is optimally allocated between operators to achieve maximum efficiency of spectrum use and minimize costs. In practice, although it is unlikely that spectrum trading will eventually iron out all the cost differences between operators, as all operators will start from a different basis in the way they use their existing spectrum, it will help to create a fairer playing field. Symmetry is an appropriate principle in a fair playing field, and only a scenario with maximum efficiency spectrum usage and minimum spectrum costs differentiation can be considered as a fair playing field. In this context, the glide path to symmetry in each national market should be influenced by the existing spectrum holdings (particularly in non dense areas which entail the major part of coverage costs) and the potential to trade spectrum to reach equal holdings between operators.

There are no other exogenous factors which are relevant to setting asymmetric rates between operators in a national market.

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*"?

We consider that a significant cost differential between operators as may be the case with significant differences in spectrum allocation is a strong reason for justifying asymmetry while these differences persist. However, in the future a glide path can be set which takes into account how spectrum differentials are evened out though trading.

Regulatory intervention to set or remove coverage obligations can also address the differential that arises through spectrum allocation.

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

In the past, substantial differences in the date of market entry have been used to justify an asymmetry for a transitory period. In our view, this kind of asymmetry is no longer justified on any basis. There is a real danger that a new entrants' business model can become dependent on asymmetric termination rates without the appropriate incentives to become efficient. Where a transitory period has been allowed, due to NRA discretion, it must be set to a defined and limited period to ensure regulatory certainty and credibility.

It is important to note here that we refer to new network entrants. Termination rates should be based on the principle of efficient network cost as outlined under our answer to question M9. Adjusting these costs to cover asymmetry for MVNOs to facilitate market entry will have a distortionary effect on competition that is not related to fundamentals of cost accounting. To be clear, the network externality allowance represents a benefit which accrues to the whole of the mobile community and should be spread across the termination rate for all operators and should not just be restricted to the new entrants and is no way any justification of asymmetry. MNOs may choose to pass on some of the termination rate in the form of the network externality to MVNOs through commercial agreement to serve the least profitable end of the market, in order to generate higher traffic volumes than they would otherwise achieve without the MVNO penetrating that segment of the market.

It is also important to consider when granting an asymmetry for a new entrant using a different technology (eg 3G rather than 2G) to terminate what is essentially a 2G service, that the new entrant should be incentivised to use the most efficient means of termination. A high 3G only termination rate could incentivise a new 3G entrant to terminate only on 3G when 2G termination through roaming could be the more efficient solution during a transition period. Therefore, we do not accept that in any circumstance, that termination rates should create an incentive for market entry.

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

The glide path to symmetry should be influenced by the competitive state of the market, structural costs and the requirement to incentivise greater efficiencies within the market and in this sense any existing asymmetry should be "reasonable". Asymmetry will be "reasonable" where it is related to the spectrum differential between operators and does not impact negatively upon the incentives for efficient operation. Where there are other methods to address exogenous cost differences, eg through license prices or spectrum refarming, NRAs should examine how intervention could reduce the justification for existing asymmetries and contribute to a new glide path to symmetry.

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

Yes, it is essential that if asymmetry is allowed, that it should be based on a glide path towards symmetry. This will help create regulatory certainty for all operators and enhance regulatory credibility for the regulator if the path is followed. This will limit incentives on behalf of the new entrant to be inefficient in order to either avoid being subject to the same level of controls as the other operators or to remain unregulated.

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

National factors should certainly be taken into account in determining the length of the transition period as the asymmetry is justified on the basis of competitive dynamics which vary between countries. However, it would also be useful to have guidance at the European level to setting limits for NRAs to follow and to prevent undue influence of one late entrant on NRA discretion.

As outlined under our answers to M2 and M3 above, we believe that spectrum refarming will address the issue of cost differentials between operators over time. However, the spectrum refarming process varies widely between countries in terms of extent and timing and it is important that glide paths are set to reflect this.

FT/Orange believe that the European authorities can set a target date by which spectrum refarming can be achieved in an attempt to align the path to symmetry.

M8. Do you agree that in specific market circumstances (MTR tariffs are significantly above MTR costs, there are high traffic imbalances between mobile operators and benefits of

asymmetry outweigh any short term disadvantages of doing so), a temporary asymmetry may limit competitive distortions?

No, if this is the case, asymmetry would induce further competitive distortions. Traffic imbalance can arise as a result of the retail strategy of a new market entrant which is skewed towards encouraging customers to make outgoing calls in order to stimulate call volumes and to win customers onto the network. It is therefore inappropriate to use a relatively blunt tool of termination regulation to address imbalances created at the retail level. Indeed, we see the link between wholesale and retail pricing as weakening despite the recent research by Genakos and Valetti[3] on the waterbed effect.

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

MTRs should be set on the basis of:

- Network cost
- Spectrum cost and frequency assignment.
- Non-network costs – eg administrative

And additional to these basic types of cost, the following externality allowances should also be incorporated in the MTR to maximise social welfare.

- Network externality (a measure of the social benefit that occurs from increasing the subscribership of a mobile network by allowing more people to be in contact with each other)
- Investment externality (the external benefit which accrues to society as a result of network investment. When operator A makes an investment decision, it does not take into account the benefit that the subscribers of operator B will experience from interconnecting with A's improved network and vice versa)

The externality effects are specific to competitive mobile networks. The network externality allowance ensures that social welfare is optimised by maximising the number of subscribers on a mobile network. The investment externality only arises with competing mobile networks because a monopoly network would internalise the benefits of investment. Externality effects imply that even if the network cost of termination were zero, the optimal mobile termination rate is not zero.

NRAs need to evaluate the country specific costs outlined above and need to understand why these vary between countries.

Recommendations

In conclusion, we support the principle of MTR symmetry in the long run but maintain that the glide path to symmetry will vary between countries. Guidance set at the European level can help to limit the magnitude of asymmetry and the length of the transition period. A strong European Framework can influence the European glidepath to symmetry by setting targets for NRAs to achieve by a certain time, for example on spectrum refarming. In our view, the next stage of the ERG consultation will be the crucial step to outlining how MTRs should be based on cost and early conclusions should not be reached until this phase is complete. We look

[3] Testing the Waterbed Effect in Mobile Telephony, Genakos and Valletti, June 2007

forward to having the opportunity to engage in discussion over the appropriate form and approach to cost modeling.

Appendix M: Reasons for differences in mobile termination rates between countries

Orange/FTGroup is very concerned that the principle of symmetry between operators should not be confused with a principle of symmetry between countries. It is in no way appropriate to impose symmetry or a uniform termination rate across Europe and to do so would be to entirely reject the rationale behind cost modelling. Termination rates must be set on the basis of a detailed analysis of relevant costs rather than applying a simplified blanket measure. The relevant costs must be analysed in detail to ensure that the hypothetical efficient operator is replicated for that particular market and this would require taking into account factors such as the following:

- 2G and 3G License fees
- The cost of the production elements (Labour, inflation rate, etc.)
- Market maturity
- The number of players (MNOs/MVNOs)
- Demand forecasts (a model would be based on a number of demand scenarios)
- The topography of the territory
- The geographical distribution of traffic (e.g. extent of under-utilisation of network in rural areas and capacity constraints in urban areas);
- Weighted average cost of capital
- Risk profile of investment
- Different market characteristics (population coverage, penetration rate, terminal subsidy, prepaid/post-paid mix, retail prices)
- Spectrum availability

We do not pretend that this is an exhaustive list by any means and is merely a representation of magnitude of factors that will cause MTRs to vary between countries.

As Orange Group with operations in France, UK, Spain, Belgium, Poland, Romania and Slovakia we are well aware of how costs vary across our European footprint. Even with the application of harmonised costing methodologies across the Group, it is evident that costs vary between our operations due to local conditions. For example, a report by Ovum has demonstrated that factors such as wage differentials and country terrain can account for differentials up to 25% higher than a European average MTR.

We look forward to having full opportunity at the next stage of the consultation to setting out why mobile termination rates should continue to vary between countries and providing evidence where appropriate.