Romtelecom comments

on the draft ANRC Decision on Regulation regarding the preparation of the “top-down” costing model for Long-Run Incremental Costs by Orange România and Mobifon

September 2003

1 Romtelecom commentary on the decision on LRIC

1.1 ANRC has published draft decisions regarding the preparation of a top-down costing model for long-run incremental costs (LRIC) by Orange/Mobifon.

1.2 In relation to the LRIC decision, Romtelecom notes that ANRC has again failed to highlight those aspects of the regulation on which it is seeking industry comment. We request that ANRC adopt this policy in future industry consultations.

1.3 We request that ANRC undertake in its elaboration of its decision on LRIC to:

- list and individually address the opinions expressed by operators in the subsequent decision;
- demonstrate the benefit which the telecommunications sector will gain as a direct result of each obligation ANRC is proposing; and
- demonstrate the advantages and/or shortcomings of each operator's response relative to ANRC's proposal in order to provide a context for ANRC's final decision.

1.4 Romtelecom believes that it is ANRC's responsibility as the primary representative of the Romanian telecommunications sector – both end users and new entrants – to accompany all future draft and final decisions with such an analysis. It will only be through the demonstration of the sustainable improvements being made to the telecommunications sector that the Romanian telecommunications sector will benefit from long-term investment.

1.5 In the following section (section 2), Romtelecom summarises its general comments on the decision regarding LRIC for mobile operators. In section 3 we set out our detailed comments on individual elements of the decision.

2 General Comments

2.1 Romtelecom supports the use by ANRC of LRIC costs as the basis for mobile termination charges. This is consistent with the approach set out in the relevant EC directives and as now being adopted throughout Europe. Unlike the termination rates for calls to fixed networks, mobile termination rates in Romania remain significantly above cost. The implementation of cost-based termination is essential to address this distortion of the telecommunications market in Romania.

2.2 Romtelecom also notes that the mobile market in Romania is one of the least competitive in Europe, with higher market concentration than in any EU country, prices similar to EU markets and high profitability. Furthermore, unlike many EU markets where both fixed and mobile markets have reached saturation, there are substantial numbers of customers of fixed telecommunications that are not customers of mobile telecommunications. These factors make it essential that any implementation of cost-based mobile termination charges does not generate any cross-subsidy from fixed to mobile.

2.3 Romtelecom also notes that, unlike in the fixed infrastructure market, the prices of mobile infrastructure have fallen substantially over recent years and are continuing to fall. In light of this characteristic of the mobile infrastructure, it is essential that careful analysis of mobile infrastructure prices

2.4 The next section (section 3) sets out Romtelecom’s detailed comments on the specific elements of ANRC’s draft decision.

3 Detailed comments on specific elements of ANRC’s draft decision

3.1 Paragraph 3.1 regarding modelled services. The services list includes SMS. This should be expanded to include SMS termination. Where SMS costs have been evaluated for regulatory purposes in other markets, retail prices have been found to be substantially in excess of costs. Underpinning the high margins from these services are reciprocal high inter-operator SMS termination charges, which act anti-competitively in the same way as the international voice accounting rate system did in the past to deter price competition on retail outbound services and inhibit the entry into the market of alternative providers. With SMS, non-mobile operators may wish to develop applications, such as from fixed-terminals to mobile SMS or email to SMS applications. Mobile operators are dominant providers of SMS termination services to their own customers, in the same way as they are for voice termination. SMS termination should therefore be subject to the same cost-based termination regulation to prevent the abuse of this dominant position, such as the prevention of the development of applications by non-mobile operators. Similarly, an additional category of SMS origination (terminated on another network) should be also added.

3.2 Paragraph 4.2.3. ANRC should further specify the length of the“modern equivalent asset” time horizon. For instance, this is unlikely to include the use of 3G technologies, which is more efficient than a 2G network, but should take account of the inclusion of PDH core network (as opposed to hub and spoke leased lines), which has a far shorter technology time horizon.

3.3 Paragraph 4.4.1. Romtelecom notes that the use of the CAPM approach is common, but more recently, financial investors also take account of other factors that might influence the cost of capital. In particular, any assessment of the cost of capital should be informed by multi-factor models to account for the small size of operators in Romania relative to their global counterparts, illiquidity of non-listed stock and, where it exists, the high book to market ratios. We also to refer to the need to maintain a consistent approach to the use of ex-ante and ex-post costs and risks below.

3.4 Paragraph 5.1. Romtelecom sees no justification whatsoever for the inclusion of 3G technology. Romanian mobile licensees do not have 3G mobile licenses nor access to the core spectrum upon which 3G networks operate. Until this is the case, any inclusion of 3G technology costs would serve only to complicate the modelling process and reduce the transparency of the outcome.

3.5 Paragraph 5.2.1. Romtelecom notes ANRC’s scorched earth approach, but feels strongly that if this approach is adopted then account should also be taken of the ex-ante risks of investment given the uncertainty of demand, and the material impact this has on network design. This would necessarily require the adoption of a cost of capital higher than that ex-post cost of capital that ANRC implies through the use of the CAPM formula. As a general point, if ANRC fails to take full account of the required ex-ante rate of return it risks undermining investment in the industry, which in Romania, more so than in most European markets, the sector cannot at this stage afford given the need for investment in infrastructure to support the development of the economy.

3.6 Paragraph 5.2.2. Romtelecom notes ANRC’s inclusion of an efficiency adjustment in the calculation. As with all such efficiency adjustments, this would be impractical and subject to a high degree of error and serve only to reduce the transparency of the calculation of costs. Any operator has an incentive to increase efficiency to provide returns to its shareholders. These incentives will ensure that any operator is reasonably efficient, so that actual costs represent a reasonable estimate of efficient costs, and far more appropriate that the inclusion of an arbitrary adjustment that fails to take into account the real-world constraints on site locations caused by geography, planning authority and commercial negotiations.

3.7 Paragraph 10.1. Romtelecom agrees with ANRC's assessment that common costs should be attributed using EPMU. Substantial analysis of this has been undertaken in other markets and concluded that the scope for the inclusion of any other methodology has no merit and will only serve to increase the complexity and reduce the transparency of the analysis.

3.8 Paragraph 10.2. Romtelecom agrees with ANRC's assessment that non-network costs should be excluded from the cost related to call termination. For the avoidance of doubt, these should be excluded from the common costs associated with call termination. The treatment of non-network costs should be the same in establishing the wholesale prices of both fixed and mobile services. In other markets, there has been argument for the inclusion of some non-network costs in the calculation of mobile termination charges. Where this ahs been the case, customers of mobile telephony retail services have been found to be largely the same as the customers of fixed to mobile calls and the mobile termination charge does not represent a transfer of value from one set of customers to another as they are the same customers. In Romania, this is not the case. In a recent market survey, 53% of RTc's residential customers made calls to mobile, yet only 33% of residential customers are also mobile customers. This suggests that a substantial proportion of calls to mobile are made by non-mobile customers and that the inclusion of non-network costs in mobile termination charges would represent not only a distortion of competition but a transfer of value away from customers of fixed telephony