TERMINATION RATES

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- Termination rates generally – rationale for regulation
- Historical evolution of methods used for calculation of TR in the EU
- EC Recommendation on TR in the EU – why is pure LRIC considered to be the best regulatory approach
- CTU´s way to regulate TR (methodology, legal actions against price decisions)
- Experience of other EU countries - „Naughty" countries (who disobey Recommendation) and EC reaction
- Phase II investigations and what have we learnt (NED, CZ, GER)
- Regulatory consequences stemming from pure LRIC TR

Fixed and Mobile Termination Rates

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Termination rates generally – rationale for regulation

- Both fixed and mobile termination markets are supposed to be susceptible to ex-ante regulation, i.e. that fulfil so called three criteria test
  - the presence of high and non-transitory barriers to entry (structural, legal or regulatory nature)
  - a market structure which does not tend towards effective competition within the relevant time horizon (the application of this criterion involves examining the state of competition behind the barriers to entry)
  - the insufficiency of competition law alone to adequately address the market failure(s) concerned
- This has consequently led to inclusion of these markets (relevant market 3 for FTR and relevant market 7 for MTR) into the EC Recommendation on relevant product and service market within the electronic communications sector (C(2007) 5406 rev 1)
- Each operator has dominant position in its own network and is subsequently believed to be able to abuse this position and behave in anti-competitive way
- Theoretically, there are constraints influencing operators´ behavior, i.e. their ability to behave independently of other market players and users – possible supply and demand side substitution (for fixed based services possibility to terminate through mobile network or vice versa, VoIP etc.) but so far these constraints have not been regarded to be strong enough to discipline operators´ behavior
- Further development is still open – EC Recommendation on relevant product and service market within the electronic communications sector is currently being rebuilt and stakeholders are taking the chance to comment on the future shape of termination markets (proposals ranging from complete cancellation due to OTT applications to simplifications of markets analysis and simplified process for remedies imposition)
- 2 September 2013 – Finish regulator FICORA proposed to deregulate market 3 and sent this proposal to notification to the European Commission (reason – mobile and VoIP substitutes)
- Currently, the major competition issue arising from 100% market share is excessive price charged initially at the wholesale level and subsequently also on the associated retail (downstream) market to the detriment of final users

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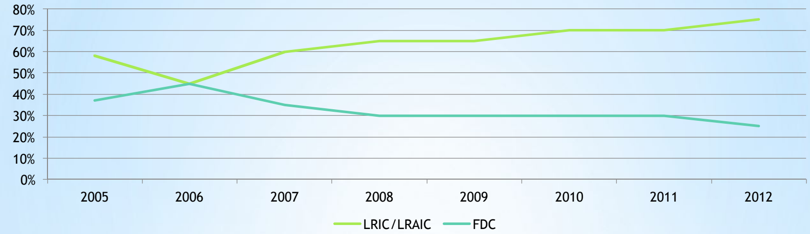
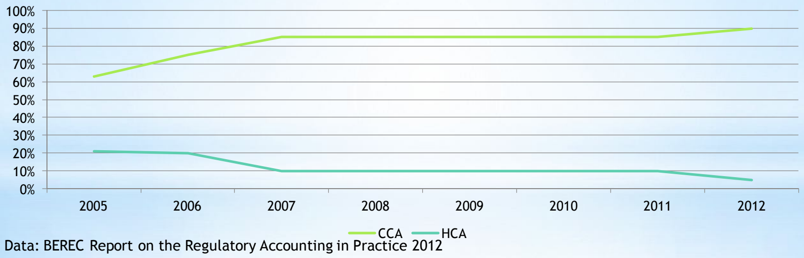
Historical evolution of methods used for calculation of FTR in the EU





Data: BEREC Report on the Regulatory Accounting in Practice 2012

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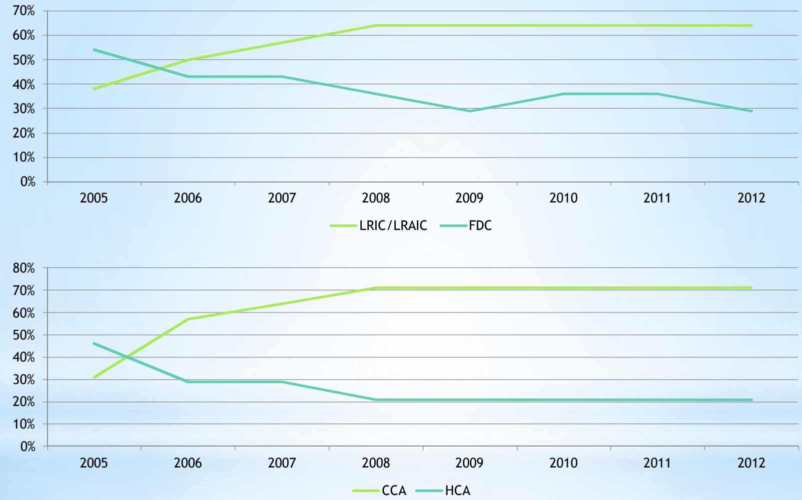
Historical evolution of methods used for calculation of MTR in the EU



Data: BEREC Report on the Regulatory Accounting in Practice 2012

EC Recommendation on TR in the EU – why is pure LRIC considered to be the best regulatory approach

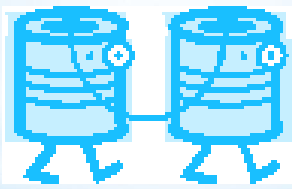
- Commission Recommendation of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC)
- As stated previously – the main reason for regulatory intervention is 100% market shares of each operator in its own network and resulting possibility of excessive pricing
- Article 13(2) of the Access Directive requires NRA to ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition and maximize consumer benefits
- These goals on termination markets should be reached by
  - Evaluation of efficient costs based on current cost and the use of a bottom-up modelling approach using long-run incremental costs (LRIC) as the relevant cost methodology
  - Imposing these efficient TR symmetrically on all SMP

EC Recommendation on TR in the EU – why is pure LRIC considered to be the best regulatory approach

- Another competition problem mentioned beside the excessive pricing is possible cross-subsidization
  - from fixed to mobile networks as MTR used to contain also access network costs while fixed operators recover access network costs (local loop) via retail subscription
  - from new entrants to established operators as those former mentioned have usually larger proportion of traffic terminated on other networks (more off-net calls)
- Operators do not have incentives to lower their wholesale termination costs as these costs are recovered from other operators, i.e. their retail competitors. Moreover, high termination costs may foreclose a new entrant network (possibly also with collusive behavior between two or more established operators)
- Therefore, there is a need to bring TR down to the costs of an efficient operator
- Termination is „two-way“ interconnection – both sides use wholesale services of the other party – this leads to possible usage of other payments methods than the CPP (Calling Party Pays) currently used in the EU – Bill and Keep possibly accompanied by retail charge for incoming calls in case the traffic between operators is not balanced
- Current costs are considered to be the cost base prevailing in a competitive market – current costs lead to lower TR (technological development) even though under historical costs principle some assets would already be depreciated and thus not included into calculation

EC Recommendation on TR in the EU – why is pure LRIC considered to be the best regulatory approach

- LRIC is supposed to be the best allocation methodology as it is in principle consistent with economic theory (price equal to marginal costs) and allows to determine appropriate incremental service (wholesale termination) and its costs
- LRIC helps to avoid the above mentioned competition problems (not only excessive pricing but also cross-subsidization)
- As the call is established only after both calling and called parties agree to do so and both parties enjoy benefits from it, it would be in line with the cost-causation principle to jointly cover costs associated with the call. Therefore, receiving operator is free to cover costs also from own called user.



CTU´s way to regulate TR (methodology, legal actions against price decisions)

- Methodology:
  - FTR – from 2001 until 2013 – CCA BU-LRAIC (with mark-up for joint costs), from 2014 CCA (pure) BU-LRIC
  - MTR – from 2001 until the end of 2012 HCA FDC, from 2013 CCA (pure) BU-LRIC (with glide path reaching the pure LRIC price from 1 July, 2013)

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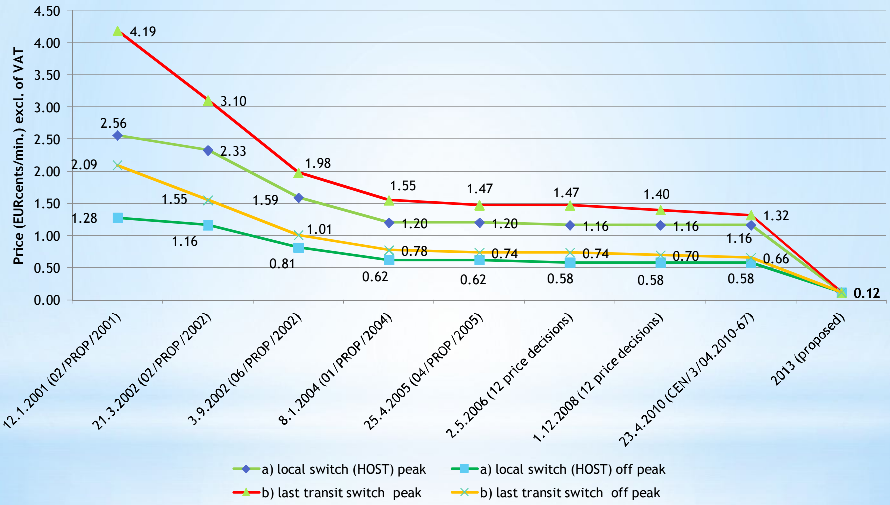
Evolution of regulated FTR



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Evolution of regulated MTR

Evolution of regulated FTR in chart

Termination with interconnection at	Traffic time	12.1.2001 (02/PROP/2001)	21.3.2002 (02/PROP/2002)	3.9.2002 (06/PROP/2002)	8.1.2004 (01/PROP/2004)	25.4.2005 (04/PROP/2005)	2.5.2006 (12 price decisions)	1.12.2008 (12 price decisions)	23.4.2010 (CEN/3/04.2010-	2013 (proposed)
a) local switch (HOST)	peak	0,0256	0,0233	0,0159	0,0120	0,0120	0,0116	0,0116	0,0116	0,0012
	off peak	0,0128	0,0116	0,0081	0,0062	0,0062	0,0058	0,0058	0,0058	0,0012
b) last transit switch	peak	0,0419	0,0310	0,0198	0,0155	0,0147	0,0147	0,0140	0,0132	0,0012
	off peak	0,0209	0,0155	0,0101	0,0078	0,0074	0,0074	0,0070	0,0066	0,0012

Legal actions against CTU´s price decisions

- All three regulated mobile operators dissatisfied with the level of calculated MTR
- January – February 2013 – three legal actions against CTU´s price decisions based on questioning the methodology used by CTU (pure LRIC)
- Operators object that Commission Recommendation on TR is not binding (Article 288 of the TFEU – Recommendations and opinions shall have no binding force)
- Pure LRIC methodology is not in line with legal requirement to set regulated price at least at costs (does not cover either joint or common costs)
- Competition problem indentified during the market analysis (excessive pricing) could be solved by a less intrusive approach (LRIC+)
- There is not direct connection between wholesale and retail prices (therefore, no or at least reduced possibility to influence retail prices to the benefits of retail users)

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Legal actions against CTU´s price decisions – defensive arguments of CTU

- Description of reasons why the pure LRIC is considered to be the best regulatory approach (see above)
- Pure LRIC allows for coverage of all costs directly associated with the considered wholesale termination service
- Commission Recommendation though nominally not binding, in reality (unjustified) breach of the Recommendation is interpreted as a breach of the Framework Directive and Access Directive
- Wholesale prices have so far formed important part of retail prices (causality), CTU has also observed long-term evolution of both wholesale and retail price levels (average prices) and have proved significant correlation
- CTU is still waiting for court´s decisions

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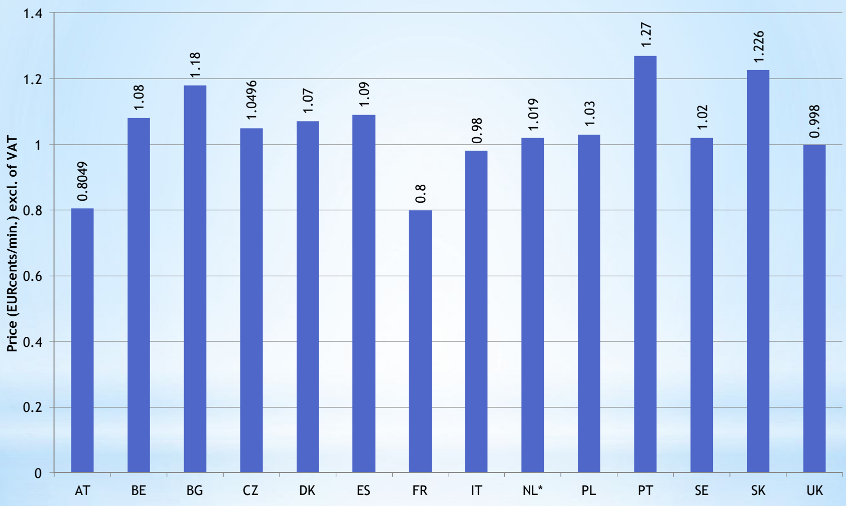
Experience of other EU countries - „Naughty“ countries (who disobeys Recommendation) and EC reaction

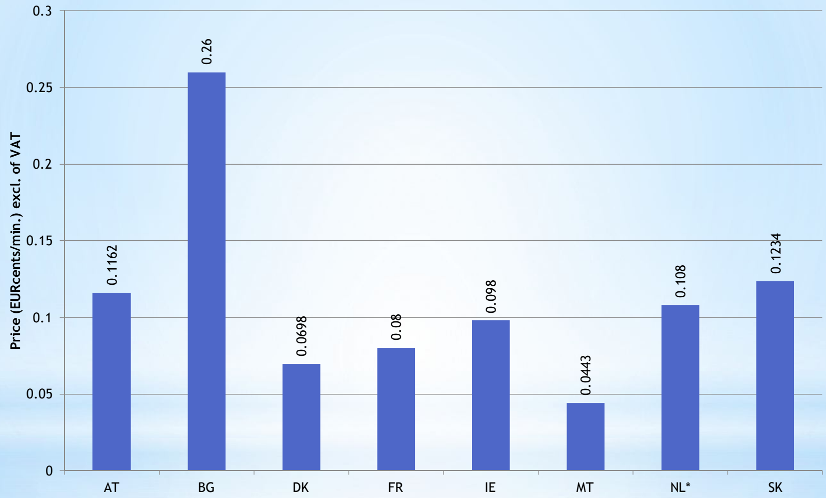
- The final deadline for Recommendation implementation was 31 December 2012 (Article 11 of the Recommendation), exceptionally 1 July 2014 for those NRAs with limited resources (Article 12 of the Recommendation) – these, however, should demonstrate that a methodology other than a pure LRIC based on CCA results in outcomes consistent with the Recommendation and generates efficient outcomes consistent with those in a competitive market (i.e. TR based on a benchmark in those countries with already implemented pure LRIC)
- Benchmark TR are supposed to be used e.g. in Slovenia and Portugal
- The number of countries switching to pure LRIC methodology is gradually rising

Experience of other EU countries – notified pure LRIC MTRs



- NL – MTR annulled by the Tribunal

Experience of other EU countries – notified pure LRIC FTRs



- NL – FTR annulled by the Tribunal, AT, DK – weighted average of peak/off-peak FTRs (+ set-up in DK)

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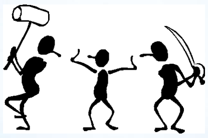
Experience of other EU countries - „Naughty“ countries (who disobeys Recommendation) and EC reaction

- So far only one NRA has actively refused to use pure LRIC methodology with regard to principal disagreement based on economic arguments (Bundesnetzagentur from Germany), one NRA was forced to refuse this methodology in 2012 (Onafhankelijke Post en Telecommunicatie Autoriteit – OPTA from the Netherlands, now ACM) with regard to court decisions – however, based on a new analysis of market 3 (FTR) and 7 (MTR) the ACM has recently (August 2013) once again opted for pure LRIC (as it once did in 2010), but…(see below)
- There are still 20 countries (71 %) for market 3 and 14 countries (50 %) for market 7 that have not implemented pure LRIC TR



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Phase II investigation and what have we learnt (NED, CZ, GER)

- European Commission may open phase II investigation pursuant to Article 7a of the FD (2002/21/EC as amended by Directive 2009/140/EC) in case it considers the draft measure (remedy)
    - Would create a barrier to the single market
    - Is not compatible with Community law
- The Body of European Regulators for Electronic Communications (BEREC) should issue an opinion on European Commission´s serious doubts (opening phase II investigation)
- The European Commission should take utmost account of the opinion of BEREC in its final recommendation (if there is any)
- Regarding TR, from January 2012 up today these phase II investigations have been held with 7 NRAs – we will take a closer look at OPTA, CTU and BNetzA (phase II investigation have experienced also i.e. ARCEP, CMT or Agcom)

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Phase II investigation and what have we learnt – the Netherlands

- OPTA (then Dutch regulator, now called ACM after merger with other regulatory bodies)
- OPTA was one of the first European regulator to use pure LRIC TR – in July 2010 notified both MTR and FTR
- A number of operators in the Netherlands appealed price control measures to the Dutch Trade and Industry Tribunal (the national court) which in August 2011 issued its judgment ruling that both MTR and FTR should be set by reference to the BU-LRIC+ methodology
- Reasons for Tribunal´s ruling
    - OPTA should have investigated whether a less burdensome measure was also appropriate
    - OPTA should not have used a cost methodology which was more onerous for the regulated operators than an alternative cost methodology which determines cost-oriented rates
    - Although OPTA tried to remedy the inefficient retail pricing structure (financial transfer from fixed lines users to mobile users) this competition problem was neither recognized as a problem in the ERG Common Position on Appropriate Remedies nor happens on the relevant market (but on the competitive retail market)

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Phase II investigation and what have we learnt – the Netherlands

  - Therefore, to tackle the competition problem identified (excessive pricing) it would have been sufficient to use BU-LRIC + methodology
  - The obligation of NRA to take into utmost account the recommendations of the European Commission does not affect the obligation of OPTA to deviate from the non-binding Recommendation on the TR if the latter would lead them to act in violation of the national law
- The Tribunal directly set in its decision MTRs as these had already been calculated by OPTA
- The Tribunal instructed OPTA to take a new decision setting FTRs based on LRIC+
- In January 2012 OPTA notified to the European Commission draft measure setting (only) FTRs
- In February 2012 the European Commission opened with OPTA phase II investigation to FTR price control and (interestingly) also to MTR price control, which, according to OPTA, was not part of the draft measure being notified (MTR were merely marginally mentioned in the draft measure but had been already set by the Tribunal)

Phase II investigation and what have we learnt – the Netherlands – BEREC Opinion (BoR (12) 23)

- BEREC issued its Opinion in March 2012 and generally, it considered European Commission´s serious doubts to be justified
- OPTA did not provide an economic justification for draft measures (which would have been difficult for OPTA as it in fact supported pure LRIC and used this methodology already in 2010)
- According to OPTA there was no need for economic justification – Article 19 of the FD requires NRA to give the reasons for not following a recommendation and this reason is a binding decision of the national court
- BEREC argued why pure LRIC is better than LRIC+ (termination is a two-way access, common costs should be recovered mainly on the retail markets which are more competitive and where there is a price constraint, lower TR would lead to lower retail off-net calls prices and thus increased competition in call charges, reduction of competitive distortions between fixed and mobile operators)
- OPTA´s approach would create barriers to the internal market as users from other Member States would have to pay in their retail prices also higher TR applied by Dutch operators (however, these TRs should have been equally applied to both Dutch operators/users and operators/users from other Member States)
- BEREC acknowledged that OPTA proposed draft measures in reaction to binding court´s decision

Phase II investigation and what have we learnt – the Netherlands – the end of the story (or not?)

- In June 2012 the European Commission issued its first Recommendation pursuant to Article 7a of the FD requiring OPTA to amend or withdraw its proposed draft measures
- As the European Commission has no right of veto (contrary to the notification of analysis) OPTA kept its measures and issued them shortly afterwards (in July 2012)
- On 31 July 2013 the European Commission notified (without any comments) new ACM´s draft measures on FTR and MTR after a new analysis of both markets
- ACM again returned to the pure LRIC methodology
- New TR should have been applied from 1 September 2013 and were as follows:
  - FTR – 0,108 EURcents/min (compared to previous 0,37 EURcents/min)
  - MTR – 1,019 EURcents/min (compared to previous 2,4 EURcents/min)
- However, the Dutch Trade and Industry Tribunal does not give up – on 27 August, 2013 annulled the pure LRIC FTRs and MTRs adopted by ACM and replaced them with TR based on LRIC+
- The tribunal rejected ACM´s argument pointing to possible distortion of the internal market where 7 % - 9 % of the termination traffic in the Netherlands is originated abroad
- According to the Tribunal this volume of traffic includes also calls originating from outside the EU and calls from EU Member States that have not yet implemented pure LRIC TR (mainly Germany), so no disadvantage would be caused by higher Dutch TR
- The decision was adopted in a fast track procedure and could be further challenged by ACM
- Is there going to be another phase II investigation? (the Tribunal has already set TR)

Phase II investigation and what have we learnt – the Czech Republic

- In November 2012 CTU sent to notification draft measures for both MTR and FTR
- Both draft measures (price decisions) were based on the recommended pure LRIC methodology
- Proposed drop in MTR – from app. 2,2 EURcents/min to 1,08 EURcents/min (-51 %)
- Proposed drop in FTR:
  - from app. 1,36 EURcents/min to 0,32 EURcents (-76 %) in peak time at transit switch
  - from app. 0,68 EURcents/min to 0,16 EURcents (-76 %) in off-peak time at transit switch
- In December 2012 the European Commission launched a phase II investigation (C(2012) 9523) by sending its serious doubts letter to the draft measure on FTR being notified (draft measure on MTR was notified)

Phase II investigation and what have we learnt – the Czech Republic – Serious doubts of the European Commission

- The primary reason triggering the phase II investigation was price comparison with other Member States with already notified FTRs
- At that time there were only 4 countries (!) with notified FTRs – Denmark, France, Ireland and Malta
- FTRs in those four countries were ranging from app 0,044 EURcents/min to 0,098 EURcents/min, so, indeed, these FTRs were lower than FTRs proposed by the CTU (0,16-0,32 EURcents/min)
- The European Commission asked CTU for explanation of differences between its FTRs and FTRs in other Member States (with pure LRIC)
- Minor concerns were raised also in connection with interconnection at the local and transit level which the European Commission found obsolete

Phase II investigation and what have we learnt – the Czech Republic – CTU´s way of defense

- The primary response of CTU to the serious doubts of the European Commission was assertion and conviction that higher FTRs cannot *per se* be considered as a proof demonstrating inconsistency with the Recommendation on TR
- The goal of the Recommendation is to harmonize the methodology rather than prices (contrary to the international roaming prices regulation) and unless the European Commission points to errors in CTU´s methodology there is no legal basis to consider higher FTRs in violation with European legislation
- The number of benchmarking countries seemed to be quite limited (only 4 countries) – moreover, the Dutch NRA – OPTA – in 2010 successfully notified (pure LRIC) FTR of 0,36 EURcents/min which was higher than FTRs calculated by CTU (0,16-0,32 EURcents/min)
- CTU described to the BEREC expert working group (EWG) the cost model used for FTRs calculation which was fully NGN based

Phase II investigation and what have we learnt – the Czech Republic – BEREC Opinion (BoR (13) 04)

- BEREC issued its Opinion in January 2013 and generally, it did not consider European Commission´s serious doubts to be justified (the second time BEREC supported CTU – for the first time in July 2012 in case of product market definition and geographic segmentation of wholesale broadband market - BoR (12) 69)
- BEREC acknowledged that, as the Recommendation does not require the achievement of a certain level of TR but recommends a methodology, TR in other countries in itself cannot be used to motivate serious doubts by the European Commission
- NRAs should not have to provide a justification why its FTRs differ from FTRs in other Member States, but should provide the European Commission with sufficient transparency regarding measures notified
- BEREC found three possibly disputed parts of the cost model that allowed alternative solutions and recommended verification of these parts
  - Level of the wholesale billing costs (significantly affects FTR)
  - Calculation of the peak and off-peak tariffs (does not have major effect on FTR)
  - Exclusion of international incoming traffic (does not have major effect on FTR)

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Phase II investigation and what have we learnt – the Czech Republic – aftermath

- In order to examine in detail BEREC suggestions CTU withdrew its draft measure regarding FTR
- Subsequently, based on research between individual NRAs and based on data from OLO, CTU excluded major part of the billing system from the traffic sensitive costs and thus also from FTR
- There will be only one aggregate FTR regardless of (peak/off-peak) time and interconnection point (differences between local and transit level are negligible)
- New FTR will be applied to all SMP on the market and should be valid in the first half of 2014
- Preliminary new FTR seems to be of app. 0,12 EURcents/min (compared to previous 0,16-0,32 EURcents/min, i.e. minus another 60 %, compared to current FTR the drop amounts to 90 %)

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Phase II investigation and what have we learnt – Germany

- In the course of the first half of 2013 BNetzA sent to notification various draft measures regarding TR – in January 2013 measures regarding MTR, in March and May 2013 measures regarding FTR (at first for Deutche Telekom, then for two other OLOs – FTRs set by national benchmark to FTRs of Deutche Telekom)
- In all cases the proposed price control measures were based on BU-LRIC+ methodology (called CESP by BNetzA – Cost of Efficient Service Provision)
- MTR should be as follows:
  - From 1 December 2012 (retrospective application) to 30 November 2013 – 1,85 EURcents/min
  - From 1 December 2013 to 30 November 2014 – 1,79 EURcents/min
- FTR should be as follows:
  - From 1 December 2012 (retrospective application) to 31 December 2014 0,36 EURcents/min in peak time and 0,25 EURcents/min in off-peak time

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Phase II investigation and what have we learnt – Germany

- Not surprisingly, the European Commission was not satisfied with both the methodology employed by the German NRA and resulting TR
- According to the European Commission the BNetzA did not provide sufficient and compelling economic reasons to show that LRIC+ methodology would be better suited for German market
- The European Commission regards approach chosen by BNetzA to be in violation of European law, namely
  - Articles 8(4) and 13(2) of the AD which require NRAs (i) to impose remedies, which are based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of the FD and (ii) to ensure that the chosen cost recovery mechanism or pricing methodology serves to promote efficiency and sustainable competition and maximizes consumer benefits
  - Article 16(4) of the FD, which requires NRAs to impose on SMP undertakings appropriate regulatory obligations
- Again, approach taken by the BNetzA would create barriers to the internal market
- Subsequently, three phase II investigations were opened with BNetzA

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Phase II investigation and what have we learnt – Germany – BNetzA arguments for LRIC+ methodology

- BNetzA includes in TR both non-traffic-related common costs and traffic-related costs, which could be attributable to services other than wholesale voice termination
- BNetzA believes that the non-recognition of common costs falls within its wider discretion to choose the most appropriate regulatory model and states that a pure LRIC methodology would not be better suited to meet the policy objectives of promoting competition and interest of citizens and consumers
- Under the pure LRIC concept interpreted in light of the Recommendation the wholesale termination service is the last incremental service (incremental costs of termination = total long-run costs of an operator providing its **full range of services** – total long-run services of that operator **not providing a wholesale call termination service to third parties**) – however, this needs to suppose that the primary reason of building a network are services provided between final users of one operator (internally), to whose all common costs should be attributed (cost-causality), but…
- …BNetzA believes there is no cause to consider services used purely internally to the network as main services and services sold externally to the network as additional services with the result that common costs would be borne only by the main services
- BNetzA´s goal is to simulate a competitive outcome („as-if competition price“)
- It cannot be proven that a competitive price for termination would oscillate to LRIC levels rather than to LRIC+ levels

Phase II investigation and what have we learnt – Germany – BNetzA arguments for LRIC+ methodology

- Theoretically, common costs could be distributed according to the price elasticities of individual involved parties (higher proportion of common costs to goods/consumers with lower price elasticity – known as Ramsey pricing), however, in the present case, it was not possible for BnetzA to determine existing price elasticities of the wholesale buyers, calling end users and called end users, in the case of competition

Phase II investigation and what have we learnt – Germany – BEREC Opinions (BoR (13) 47, BoR (13) 55, BoR (13) 94)

- BEREC issued its first Opinion on German disputed measures in April 2013, then in May 2013 and finally in August 2013 – not surprisingly, all opinions have similar line of argumentation and the same result – the serious doubts of the European Commission are justified
- The main argument of BEREC is that the legal starting point for BNetzA analysis has to be the pure LRIC approach as laid down in the Recommendation on TR and not the LRIC+
- In other words, BNetzA should not have asked whether the pure LRIC was better than LRIC+ but the other way around – whether the LRIC+ was better than pure LRIC (default setting)
- This comes from Article 19 of the FD (*…where a NRA chooses not to follow a recommendation, it shall inform the Commission, giving the reasons for its position* – i.e. to give reasons why any alternative approach – e.g. LRIC+ - is better than pure LRIC)
- To the emulation of competitive price (TR) carried out by BNetzA, BEREC states that it is not necessarily the case that even in highly competitive markets a multiproduct firm will allocate joint and common costs an (equal proportionate or volume proportionate) mark-up – in many cases prices only cover incremental/marginal costs
- BNetzA´s approach (allocating joint and common costs) does not lead to efficient allocation (causes welfare losses) as it does not take into consideration call externality occurring under a CPP regime (the called party has a call benefit it does not pay for)
- Pure LRIC takes this externality partly into account (not wholly as it would be difficult anyway to estimate call utility for called party) by excluding joint and common costs from TR

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Phase II investigation and what have we learnt – Conclusions to German phase II investigations – possible next steps of the European Commission

- Following BEREC´s opinions on the German draft price measures, the European Commission has issued its recommendations pursuant to Article 7a of the FD requiring BNetzA to amend or withdraw its proposed draft measures
- In relation to countries that do not intend to implement Recommendation the European Commission may possibly do one of these things:
  - Take into account that, as recommendations are not binding, not all countries will comply with that (if the intention was to make it uniformly applied throughout the EU, then some „hard“ piece of law should have been applied)
  - Use Article 19 of the FD allowing it to issue decision on the harmonized application of the provisions in FD
  - Possible action at the Court of Justice of the EU for violation of the FD and AD?

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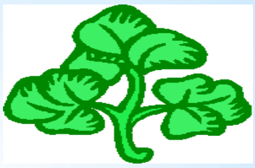
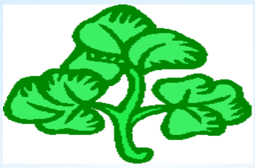
Experience of other EU countries – Italy, Ireland



- There have been several other phase II investigations launched by the European Commission – however, some of them were finished by withdrawing draft measures by NRA (Latvia with FTR, Spain with MTR)
- Italian NRA Agcom initially (in the first half of 2013) proposed glide path towards pure LRIC FTR which should have been reached on 1 January, 2015. The European Commission disagreed with such a delay in application of pure LRIC FTRs and subsequently, BEREC backed serious doubts of the European Commission – Agcom withdrew its draft decision
- Recently (August 2013) interesting ruling came from the Irish High Court that ruled that ComReg (Irish NRA) was not legally allowed to use benchmarking approach as a regulatory price control
- At the end of 2012 ComReg adopted decision setting MTR of 1,04 €cents/minute for six mobile operators (MNO, MVNO) from 1 July, 2013 – MTR was based on international benchmark of seven EU countries with already adopted pure LRIC MTR (ComReg is still working on its cost model)
- The Irish High Court has ruled that price control must be based on an actual cost analysis relating to the individual operator upon which the price control is imposed

Experience of other EU countries – Ireland



- In Court´s view it is highly questionable whether the use of an „arithmetical short cut“ of adopting the average of the rates that happen to be available from other NRAs can be considered as a methodology
- Neither EU Directives nor Irish legislation allow cost accounting method that is based on costs other than those of the operator in question
- Ruling is based (also) on Article 13(1) of the AD - *…to encourage investments by the operator, including in NGN, NRA shall take into account the investment made by the operator, and allow him a reasonable rate of return on adequate capital employed, taking into account any risks specific to a particular new investment network project*
- Although the Recommendation on TR mentions (recital 22) benchmarking as an example of a methodology that could be used in the transition to the recommended cost model (until 1 July, 2014), this has no material legal impact
- Final order from the court was expected in October 2013, so current MTR is still valid (however, there could be retrospective MTR adjustments if the court finally rules in line with its judgment)

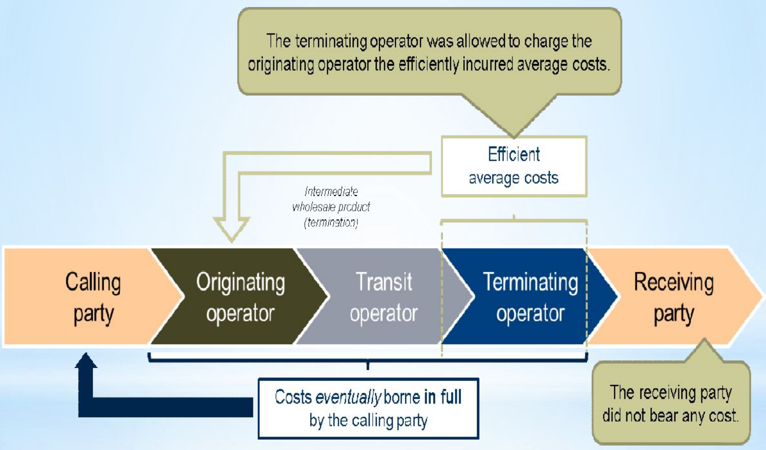
Regulatory consequences stemming from pure LRIC TR

$\Rightarrow$

- How does the Recommendation on TR influence regulatory decisions on other relevant markets?
- Is needed revision of regulation on relevant market 1 and 2?
- Under what conditions?
- How the adjustments should be done?

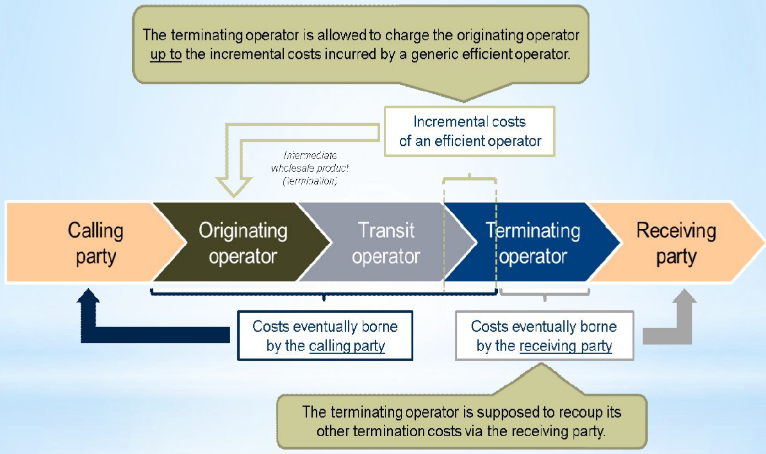
Regulatory consequences stemming from pure LRIC TR – cost recoupment

- Termination cost recoupment before the Recommendation on TR (based on research made by BEREC)



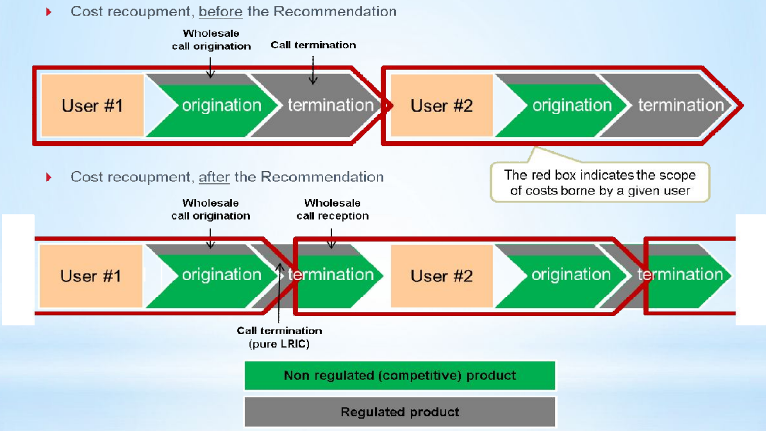
Regulatory consequences stemming from pure LRIC TR – cost recoupment

- Termination cost recoupment after the Recommendation on TR



Regulatory consequences stemming from pure LRIC TR – cost recoupment

- The costs stack has remained unchanged, however, shift has occurred in the cost recoupment - the share of costs recouped via competitive (non-regulated) products may increase



Regulatory consequences stemming from pure LRIC TR – when there is no need for any regulatory adjustments?

- Generally, there are two situations not requiring any regulatory intervention/adjustments
  - When the traffic between operators is balanced (not very likely situation) – costs excluded from TR under the pure LRIC concept (joint and common costs) may be fully recouped by operator´s savings resulting from lower outgoing termination charges (retail revenues previously used for payment for termination)
  - There is no regulated service (in association with termination) – namely services from relevant market 1 (access to the public telephone network at a fixed location) and relevant market 2 (call origination on the public telephone network provided at a fixed location – CS/CPS or WLR) – operator may freely recoup costs by an adjustment of its retail tariffs (direct recoupment from retail users) or by an adjustment of its wholesale (unregulated) tariffs (indirect recoupment)

Regulatory consequences stemming from pure LRIC TR – when there is need for regulatory adjustments?

- Generally, when the above mentioned conditions are jointly fulfilled, i.e.
  - The traffic between operators is not balanced
  - Operator is not free to set and adjust prices of its services
- If an operator provides also regulated wholesale services (CS/CPS, WLR) it would be discriminatory to demand all joint and common costs be recouped only from the retail users of that operator
- Examples:
  - Network operator would in reaction to pure LRIC TR raise its retail tariffs (prices/minute) while CS/CPS operator (bearing no investment risks) would only profit from lower TR for outgoing traffic without need to pay higher origination rate for CS/CPS – therefore, would, contrary to the network operator, lower its retail prices (prices/minute) – leads to competitive distortion
  - Network operator would in reaction to pure LRIC TR raise its retail access charge while WLR operator (bearing no investment risks) would again only profit from lower TR for outgoing traffic without need to pay higher WLR - therefore, would offer lower retail access charges (line rental) than network operator – leads to competitive distortion
- Conclusion – joint and common costs excluded from TR should be non-discriminatory attributed to both retail services of an operator and to its regulated (mostly wholesale) services

THANK YOU FOR YOUR ATTENTION!

Any questions, any time at:

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