This document sets out MobiFon's views on ANRC draft document "Decision for Approving the Regulation on the Realisation of the "Top-Down" Costing Model or the calculation of the Long Run Incremental Costs", dated 11of August 2003.

In this context, it addresses a couple of key issues which, in MobiFon's views, require consideration in the context of developing a robust, accurate and in line with Romanian market characteristics, conceptual design to underpin LRIC modeling.

MobiFon wishes to express its positive view of the open and transparent consultation process initiated by ANRC in the context of assessing the efficient level of call termination charges. Furthermore, MobiFon is fully committed to being actively involved in this process, in order that ANRC can draw upon the experience and knowledge of MobiFon as an actual operator facing real world decisions in the Romanian market.

MobiFon welcomes ANRC's proposals regarding a systematic and transparent approach to determining the costs of call termination. However, MobiFon is keen to point out that cost information, whilst invaluable in setting economically efficient prices, only provides a part of the whole picture.

In order to determine efficient prices, knowledge is required of the demand systems within which services are offered and consumed and, specifically, the own and cross-price elasticity of services which determine:

(i) how fixed common and joint costs should best be recovered; and

(ii) the magnitude of any network externality.

MobiFon is concerned that ANRC is more focused on the service costing, without giving due consideration to:

(i) how these mobile termination charges will influence the future development of the mobile industry in Romania;

(ii) how the Romanian market characteristics and industry objectives will be reflected in these mobile termination charges (or at least not being obstructed by these);

(iii) how cost information should be used, in conjunction with demand data, to determine efficient prices

MobiFon is concerned for the level of cost details requested by ANRC that are well beyond the necessity of calculating incremental costs for mobile termination rates. According to Ch. 1.1, the ANRC's objective for this regulation is to '…realize the 'top down' costing model for the calculation of the long run average incremental costs…for the activities related to interconnection and access to the network…'.

The development of LRAIC does not require the level of detail identified in the draft regulation, thus providing such details is not only unnecessary but not relevant for the ANRC's objective and not justified by the ANRC decision 143/2002 for designating MobiFon as having SMP only on the call termination market in own network.

As we stated many times, MobiFon consider that ***ANRC should be more focus on the impact of the regulations***, on how these new particular mobile termination charges could positively or negatively influence the Romanian market development and not on the very technical details of how costs are calculated.

In our opinion a regulator should provide the basic guidelines and principles for cost estimation, but this document provides far more detailed specifics than appropriate, and unnecessarily constrains MobiFon in its ability to estimate fair and real top-down mobile termination costs.

MobiFon believes that the approach being adopted presents a real opportunity for ANRC to establish an outcome that maximizes social welfare and provides a catalyst for development, growth and innovation in the marketplace.

MobiFon does, however, believe that there are a few key areas where ANRC's approach will unequivocally lead to a suboptimal outcome, to the detriment of consumers, operators and the development of the market as a whole.

These areas are:

- European context;
- MTRs national vs international ;
- Time horizon for MTRs;
- Network externalities;
- Increment definition;
- Non network costs (non network retail expenses, operating expenses treatment);
- Minimum coverage treatment;
- Efficiency;
- Common costs treatment & Mark-up mechanism;
- Cost of Capital;
- Assets in course of construction (AICC);
- Audit opinion for the costing model;
- Other (RFP for the ANRC's BU, network elements list).

MobiFon believes that ANRC must reconsider these areas, in order to preclude the adoption of an approach which has a very real risk of drawing inappropriate conclusions and adopting regulatory remedies which are not consistent with benefiting consumers and generating appropriate incentives in the mobile market.

As shown by a rough comparison between MTRs in candidate European countries (‘3rd Report on Monitoring of EU Candidate Countries – Telecommunication Services Sector, 16 June 2003) only the Czech Republic and Romania apply significantly lower charges in comparison with the ***EU average of 18.94 Euro*** cents per minute. Even in developed countries the MTRs agreed with NRAs and as a result of detailed cost modeling exercise are higher than ones imposed by ANRC.

ANRC decision to reduce MTRs in 2003 at 11 US cents per minute does not appear to be in line with EU market evolution and practice regarding MTRs.

MobiFon emphasizes the difference between assessing costs and setting prices based on the cost data. ***Price setting requires consideration of much more than costs*** and the literature on this is extensive [1] Price cap regulation properly applied should provide incentives for firms to become more efficient. Lower costs of production lead to higher profits even when prices (and therefore revenues) are regulated.

MobiFon believes that there is a danger that ANRC will seek ***to reduce termination charges to unrealistically low levels*** on the basis of cost modeling without considering wider implications for the industry, Romanian consumers and Romanian economy.

MobiFon consider that any further intervention on the mobile termination charges in Romania should be preceded by a ***detailed report analyzing the direct and indirect effects resulted after the first ANRC intervention for reducing the mobile termination rates from 12 to 11 US cents per minute.***

[1] For example Littlechild S.C., 1983, *Regulation of British Telecommunications’ Profitability*, London: Department of Industry, HMSO.

MobiFon recommend that ***any decision to impose regulation***, that might have significant implications to the industry, ***should be accompanied by a Regulatory Impact Assessment*** developed by ANRC through open consultations with the market players.

Due consideration should be allocated to the mechanism through which the mobile termination charges used by operators will reflect the cost estimated with LRIC methodology.

A very poor and simplistic mechanism that should be strictly avoided is ***to cut off the mobile termination charges immediately*** to the level of LRIC cost plus mark-up for common costs and externalities allowed.

The danger of adopting such mechanism is particularly important for Romania and ***against the ANRC and Government objectives*** because of the following ***main macro effects of such approach***:

- ***Slow down the increases of the mobile penetration rate in Romania*** in contrast with other countries where penetration levels closer to saturation;

- ***Universal Service will become very hard to accomplish***; the ability of MNO's to reduce the Universal Service need diminishes;

- ***Reduces the foreign investments in the telecom industry***;

- ***Endanger the mobile operator's ability to further invest in 3G*** licenses, technologies and services which is against the consumer's interest;

- ***Facilitate the hard currency export from Romania*** and from the telecom industry because the unbalanced international termination rates;

- ***Facilitate fraud and poor quality international traffic*** by maintaining the huge gap between national and international termination rates;

- One off price cuts can lead to stranding of investments which can no longer be recovered and as such ***eliminates investment incentives***.

Network externalities issue is also of particular importance in Romania where penetration of telecommunication services is relatively low. This is because increases in mobile penetration – which will be encouraged by lower entry prices reflecting network externality – will not only serve to increase social welfare in a general sense, but may also serve ***to meet key Government objectives in terms of universal service provision***.

International context should also be considered, network externalities being recognized by NRAs of developed countries with a high degree of penetration of telecommunication services.

Externalities should be included in MTRs – being calculated as mark-up over LRAIC. Whilst the literature in other markets has been developed during a process trending towards increasing market saturation, in ***Romania the market is a significant way from saturation and thus the externality is material.***

ANRC's **definition of the two increments** – 'customers' and 'traffic' – precludes recognition of the true network fixed common costs of the business. Cost of handsets should be ***treated as a common cost of true mobility services*** and not as a service in their own right and costs of location updates should be allocated to incoming and on-net calls in proportion to the number of minutes.

- *ANRC's proposed increment definition, and resulting inappropriate treatment of coverage-related costs, will result in a misunderstanding of the cost structure of a mobile business, and lead to* ***incorrect conclusions being drawn about the efficient levels and structure of prices****.*

- *The manner in which the* ***minimum coverage network*** *is dimensioned assumes a degree of perfection and super-efficiency not observable or achievable in the real world. The total costs of a minimum coverage network should include those costs incurred to provide a minimal calling capability as common across services.*

Non-network retail expenses as customer acquisition, customer retention or customer care should be considered as a joint cost across all usage based services, being substantial and necessary costs of an MNO.

Whilst in a saturated market the ***costs of acquiring customers*** (e.g. Handsets, discounts, sales costs and promotions etc) can be argued to be incurred not to expand the overall network, but merely to switch users from one network provider to another. These switching costs may have lesser social welfare enhancing properties. This is not the case in a market like Romania where such costs ***are targeted at expanding the network overall***.

MobiFon believes that, given the competitive nature of the market and its relatively new establishment, ANRC should work on the basis of an *a priori* expectation of efficiency. As a consequence, MobiFon does not believe any form of **inefficiency adjustment** can be identified and quantified with any degree of confidence.

The use of the EPMU (equi-proportional mark-up) in the proposed model should be replaced by **Ramsey** pricing considering that without recognition of the demand characteristics of the market, and the appropriate definition of fixed common costs, prices will be set to the detriment of consumers and the development of the industry.

An EPMU-based approach, whilst straightforward to apply, will yield a sub-optimal outcome where (i) demand sensitivities differ across individual services and (ii) there exists a network externality.

Cost of equity calculation should not be a priori restricted to only one method (CAPM-Capital Asset Pricing Method), given ANRC's objective to provide basic guidelines and principles in respect of different matters and not to limit by indicating specific methods for calculating capital assets prices.

There is a ***contradiction regarding ANRC position***: on the one hand it is very concerned about MNO costs and efficiency, whilst, on the other hand, ***encourage huge an unjustified costs for the operators.***

The industry in Europe is gearing up for a very significant spend on LRIC modeling over the coming few years. The UK process involved each of the UK operators spending millions of pounds on the cost on internal resources and consultants and the regulators required similar consultancy services and was required to devote tens of staff to the process.

In our opinion **audit of costing model** represents an unjustified expense for the MNO and the industry as a whole due to:

- huge costs already involved by LRIC development, both for operators and ANRC;
- considerable costs incurred: audit fees for compliance with regulations are two-three times higher than audit fees for financial statements;
- interference of a fifth party between ANRC, MNO and external consultants (one for ANRC and one for MNO);
- the very tight and detailed allocation rules contained by the proposed model which enable an easy reconciliation/ control process.

MobiFon is aware that the developed LRIC should reflect a true and fair view on the MNO cost structure, consistent with ANRC decision and costing methodology, but MobiFon is willing to provide all necessary support for any further reconciliation required in this respect.

Each of the MNO's in Romania and the ANRC will be required to spend many, many months in a detailed process expending very significant resources on this modeling process. MobiFon believes that it is in the interests of all the parties and Romanian consumers that the industry and the ANRC seek to agree in advance a timetable and to reach consensus on the key methodological inputs to the model (Non-Network costs, externality, Ramsey, Cost of Capital), thus confining the detailed and lengthy subsequent process to quantifying the issues.

MobiFon is confident that ANRC will treat these issues with the required attention and will adopt the wise and appropriate approach for the regulation on the realization of the ‘Top-Down’ costing model for the calculation of the LRIC, as used by other developed EU countries and not the more simplistic and danger one.

MobiFon considers that, given the high importance of the areas mentioned above, prior to the issuance of the final decision regarding realization of ‘Top-Down’ costing model for LRIC, ANRC should initiate ***open consultations separately for each of these aspects***, with the objective of heaving a common understanding and a common agreement on these for maximization of the same welfare and development of the mobile market in Romania.

Summary of MobiFon proposals

1. **Freezing MTRs:** *MobiFon MTRs for should be frozen at 11 US cents per minute until the finalisation of LRIC development process.*

2. **Analysis of the first decision to decrease MTRs:** *A detailed report analyzing the direct and indirect effects resulted after the first ANRC intervention for reducing the mobile termination rates from 12 to 11 US cents per minute.*

3. **Time horizon for MTRs:** *MobiFon considers that ANRC should address the reducing mechanism in this decision; MobiFon consider that a time scale of 5 years with the starting point of 11c/min for 2004/05 is the most realistic approach.*

4. **Network Externalities:** *Externalities should be included in MTRs – being calculated as mark-up over LRAIC.*

5. **Increment definition:**

    - *The cost of handsets should be treated as a common cost of true mobility services and not as a service in their own right;*
    - *Allocate the costs of location updates to incoming and on-net calls in proportion to the number of minutes.*

6. **Non network costs:** *Non-network retail expenses should be considered as a joint cost across all usage based services.*

7. **Minimum coverage treatment:** *The total costs of a minimum coverage network should include those costs incurred to provide a minimal calling capability as common across services.*

8. **Inefficiencies adjustments:**

- *MobiFon considers itself to be efficient;*
- *MobiFon does not believe inefficiency adjustments can be identified and quantified with any degree of confidence;*
- *MobiFon does not, for these reasons, believe any inefficiency adjustments to be appropriate.*

9. **Treatment of Common Costs:**

- *MobiFon strongly disagrees with ANRC's proposal that fixed common costs should be recovered under an EPMU approach;*
- *Without recognition of the demand characteristics of the market, and the appropriate definition of fixed common costs, prices will be set to the detriment of consumers and the development of the industry;*
- *Replace the use of an equi-proportional mark-up (EPMU) in the model by Ramsey pricing.*

10. **Cost of capital estimation:** *Cost of equity calculation should not be a priori restricted to only one method (CAPM).*

11. **Assets in the course of construction (AICC):** *Identify the level of investment in assets which are yet to establish revenue-generating capability and uplift the unit costs of relevant assets accordingly.*

12. **List of network elements:** *MobiFon considers that list of equipments provided by ANRC to be considered for LRIC modelling (Annex 1) is neither complete nor consistent with an operational GSM network.*