Interim Review of Wholesale Mobile Termination Rate

Response to Consultation and Decision

June 2012

Document No:	**MCA/D/12-0871**
Date:	**28/06/2012**

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Table of Contents

1 Introduction

The Malta Communications Authority (hereafter 'MCA') published a decision in August 2011 entitled *Review of Wholesale Mobile Termination Rates 2011* (hereafter '2011 MTR Decision'), which set the applicable mobile termination rate (hereafter 'MTR') for all operators having been designated with an SMP status in the mobile termination market at €4.18 cents.

This rate was based on an average of the lowest 75th percentile of the MTRs[1] prevailing in the European Union Member States. In view of the feedback received during the preceding consultation process, particularly that received from the European Commission (hereafter 'the Commission'), the 2011 MTR Decision reserved the right to consult on a change in methodology of its interim MTR-setting mechanism, in the eventuality that 25% of Member States do not report rates based on 'pure' LRIC in subsequent BEREC Snapshot Reports. In this regard, the decision stated that the MCA could propose a change in the interim mechanism to take into account those reference rates based on a 'pure' LRIC target (including those rates which are set on a glide path towards the 'pure' LRIC rate). The 2011 MTR Decision also stated that it was to serve as an advance notice that the MCA might change its interim methodology following consultation with stakeholders[2].

Pursuant to the above, in March 2012 the MCA surveyed the most recent BEREC Snapshot Report (July 2011) available at the time, which resulted in a shortfall in the minimum representation threshold of 25% of countries setting a 'pure' LRIC rate.

In March 2012, the MCA accordingly published a consultation document entitled *Interim Review of Wholesale Mobile Termination Rate – Consultation and Proposed Decision*, proposing a glide path rate of €2.45 cents based on an adjusted interim methodology referred to above. This rate was calculated to yield the same percentage change from both the present MTR and the indicative target rate. The indicative target rate in turn was estimated on the simple average of the 'pure' LRIC target rates of the Member States in the July 2011 BEREC Snapshot Report. These 'pure' LRIC target rates were deemed as those rates which NRAs have decided will be achieving by the end of 2013.

The consultation also proposed an adjustment mechanism that would be refining this target reference rate to the average of 'pure' LRIC rates as reported in

[1] As featured in the BEREC MTR Snapshot Report (as at January 2011).
[2] See also Decision 2 of the MCA's 2011 MTR Decision

subsequent BEREC Snapshot Reports, and ultimately with the Maltese 'pure' LRIC based rate.

This report on consultation and decision is organised as follows:

- **Section 2** contains a summary of the feedback received from the respondents;
- **Section 3** contains the MCA's position in relation to these comments; and
- **Section 4** contains the MCA's decision on the proposed interconnection charges.

The MCA takes the opportunity to thank the respondents for their contribution.

2 Summary of responses

2.1 Responses Received from Local Operators

The consultation period ended on 30 April 2012, with two operators, Melita plc (hereafter 'Melita') and Vodafone Malta (hereafter 'Vodafone') submitting their formal feedback.

The MCA thanks these respondents whose feedback is being analysed hereunder.

2.1.1 Proposed Methodology and Indicative Target rate

Melita welcomed the MCA's proposal to reduce the MTR again. However it claimed that the indicative target rate is still high and that the 'pure' LRIC rate derived from the cost model is very likely to be lower than in other EU Member States. It suggested that the cost of deploying and operating a mobile network in a small densely-populated country is likely to be lower than in other countries.

Melita commented that the MCA should revisit the LRIC target rate to ensure that this is aligned with data recently published by the Commission. In the calculation of the indicative target rate, Melita noted that the UK glide path ended in 2014/2015 with a lower rate than that used in the MCA's benchmark. Melita claimed that no supporting explanation on the basis of the UK rate used by the MCA, as well as noting that Italy and Spain were not included in the benchmarking, even though they have a 'pure' LRIC rate.

Vodafone, on the other hand, commented that Maltese operators are relatively small and unable to benefit from the same economies of scale as operators in other Member States. This would lead to the average traffic cost in Malta being higher than in other Member States. Vodafone stated that the MCA is pushing operators ahead of the benchmark, since the MTRs on which the indicative target rate is being based are due to be implemented by the end of 2013.

Vodafone noted that since the 25% threshold has not been reached, the MCA should have calculated the interim target rate using the lowest 75th percentile as in previous decisions; however using data applicable at the end of March 2012 from alternative sources such as Cullen International. Vodafone also stated that if the MCA is to use the rate that Member States have established from their 'pure' LRIC model, the Authority should use the maximum rate rather than the average rate to reduce the risk that the indicative target rate is set below the efficient level for Malta.

Vodafone disagreed with the inclusion of the Dutch rate since it has been overturned by the Dutch Trade and Industry Appeals Tribunal, whilst both respondents stated that the Hungary rate is not based on 'pure' LRIC.

Vodafone also expressed its reservations on the MCA's proposed refinement mechanism of the indicative target rate as this will create uncertainty in the industry.

2.1.2 Interim Rate

Melita commented that the Malta interim rate is at an unacceptably high level *vis-a-vis* many other EU Member States, and that, given that this rate is not based on 'pure' LRIC, it does not conform to the principles of the EC Recommendation[3]. Melita also remarked that the interim rate should come into effect from mid- or end-May 2012, instead of the proposed effective date of July 2012.

Vodafone stated that the MCA should avoid the implementation of a glide path following the adoption of the revised rate, since the target rate would not be truly reflective of the conditions prevailing locally. This would risk that the rate prevailing after the interim adjustment would be below-cost. Vodafone also claimed that the MCA's attempts at revising the MTRs is premature and may result in disruptions to the mobile industry.

2.1.3 Compliance with European Commission recommendation

Melita claimed that the MCA already expects that it will not be in a position to have its own 'pure' LRIC models for both mobile and fixed networks by end-2012. In this regard Melita remarked also that the MCA failed to explain how, in the absence of the 'pure' LRIC models, it intends to comply with the EC Recommendation's deadline.

Furthermore, Melita stated that the MCA has not made any adjustment to the FTR since September 2010.

Vodafone on its part expressed its concern that any reduction in MTRs is not transferred to consumers for both mobile and fixed telephony, claiming that unlike mobile telephony rates, retail fixed telephony rates were not decreasing.

[3] Commission Recommendation of 7.5.2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU

2.2 Response received from the EU Commission

On 21 June 2012, the Commission sent its Art.7 Decision (hereafter 'Comments Letter') concerning the proposed MTR review for 2012. In its comments letter, the Commission expressed reservations on the MCA's proposed methodology to benchmark with the 2013 rates set by NRAs having a 'pure' LRIC model, stating that this benchmark should be based on rates at the end of the glide path of each benchmarked country. The Commission noted that the BEREC MTR Snapshot Report of January 2012 "does not contain information - which is reliable and readily available - on all rates in the Member States that have adopted the recommended pure BU-LRIC methodology". In this respect the Commission gave an updated list of countries which had so far notified it with a 'pure' BU-LRIC cost model for setting MTRs (see Appendix 1).

The Commission acknowledged the reasons why the MCA might not be in a position to conclude the development of a BU-LRIC model for mobile call termination by 31 December 2012. However it called upon the Authority to modify its benchmarking method in such a way that it would lead to reduce MTRs in line with the Termination Rates Recommendation, already in the period preceding the implementation of its BU-LRIC model, in order to avoid excessively steep drops at the end of the transition and to bring the benefits of lower MTRs more quickly.

The Commission also urged the MCA to include the readily available and reliable information on effective target MTRs as calculated by all NRAs that have already developed the recommended cost methodology and apply such a target rate, rather than an interim rate on a glide path, by the deadlines in the Termination Rates Recommendation.

The Commission also took note of MCA's strong commitment to implement its BU-LRIC model for mobile call termination by 30 June 2013 at the latest, subject only to unforeseen circumstances related to the procurement process.

3 MCA's Response to Consultation Feedback

3.1.1 Proposed Methodology and Indicative Target Rate

With respect to both operators' comments on the likely standing of the proposed indicative target rate *vis-a-vis* that emanating from Malta's eventual 'pure' LRIC model, the MCA feels that the operators' conflicting conclusions relative to each other reinforces the Authority's position to establish an indicative rate solely for the setting of the interim MTR. For the avoidance of doubt, the MCA would like to clarify that the proposed methodology was designed to eventually substitute this indicative rate by its model-based counterpart by the time of the next MTR review.

In fact, in the proposed decision, the level of the indicative target rate was only disclosed in so far as to offer the required transparency on the derivation of the interim rate.

In response to Vodafone's reservation on the change in methodology, the MCA would like to reiterate that it had given ample advance notice by way of its 2011 decision on this eventuality.

Furthermore, in response to both operators' sundry comments on the source and basis of the benchmarks, the MCA would like to clarify further the rationale behind the choice of the BEREC Snapshot Report.

This report is issued on a bi-annual basis using data obtained from all the European NRAs. These NRAs in turn fill in a detailed and standard questionnaire. Data from this report is therefore official and is considered by the MCA as a reliable and consistent source of information.

Being a standard report, with a set cut-off and update frequency, inevitably compromises on the timeliness of the data reported relative to the time of publication, which in part explains the issues related to the countries and rates used or excluded in the benchmark mentioned by the respondents. This notwithstanding, the MCA still believes that at the cost of less timely data, for the purpose of setting the interim rate, the BEREC Snapshot Report is still a reliable source of information.

Another feature of the BEREC Snapshot Report explains the differences apparent in those Member States that have set glide paths beyond 2013 to reach their 'pure' LRIC rates. This is because the BEREC Snapshot Report features the rate expected to prevail at a given time in the future (end 2013 in the case of the July 2011 report), as opposed to the 'pure' LRIC rate *per se*. The MCA is confident that by

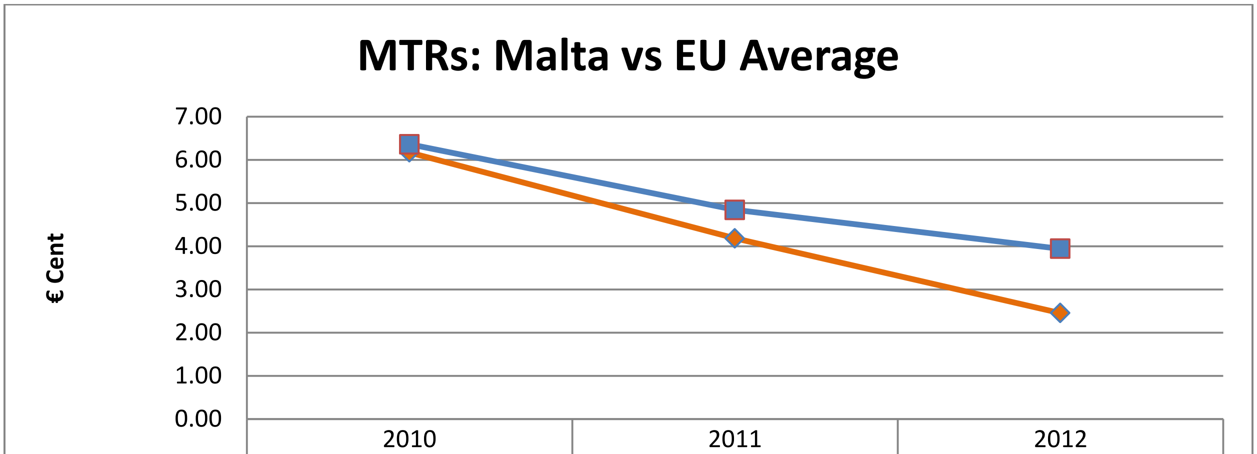
2013 the Maltese 'pure' LRIC model would be completed and hence, for the purpose of setting the indicative target rate, the end-2013 data was deemed as the indicative 'pure' LRIC rate for those countries reporting a compliant model.

Nevertheless the MCA agrees in principle with the operator's comments that one should, as much as possible, use the most recent data available. Since the rates included in the Commission's comments letter can be regarded as reliable and coming from an official source, these fulfil the Authority's pre-requisite to be used as reference rates for its benchmarking methodology and hence could substitute the BEREC Snapshot Report. The details on the resulting interim rate are found in Section 3.2 and Appendix 1 hereunder.

With respect to Vodafone's view to take the maximum of the reference rates within the benchmark, the MCA is of the opinion that for the purposes of the present exercise the use of the average is more adequate given the uncertainty on the standing of the Maltese model-based rate. Furthermore, the EC Recommendation refers to the average rates based on 'pure' LRIC when setting guidelines on the outcomes of alternative methodologies. In addition, one has to keep in mind that the indicative rate was used solely to derive a reasonable interim rate. Notwithstanding, the MCA sees the validity that the MTR set on a benchmarked basis in the present circumstances should not be below the actual modelled rate.

3.1.2 Interim Rate

In response to Melita's claim that the interim rate is at an unacceptably high level *vis-a-vis* many other Member States, the MCA would like to point out that as depicted in the graph hereunder, the Maltese MTR as from 2010 was broadly kept below the EU average, and remains so even if the proposed 2012 MTR (as featured in the consultation document) is taken into account.



	2010	2011	2012
MCA	6.17 (Jan)	4.18 (Jan)	2.45 (July)
EU Average	6.36 (Sept)	4.84 (Sept)	3.94 (Jan)

Graph 1 – Maltese MTR (2012 - proposed) compared to EU Average (Source of EU Average: BEREC Snapshot Report January 2010 – 2012)

With respect to Melita's remarks on the proposed effective date of the MTR decision, and its suggested mid/end-May alternative, the operator is not taking into account Article 7(A) of the EC Framework Directive notification procedure incumbent on this decision. When this is factored in, July will result as the most viable and earliest effective date.

In the meantime, the adjustment mechanism's purpose was to keep operators updated on the movement of the indicative rate and advise the operators one month in advance of any changes in the MTR. After taking into account the uncertainty emanating from the operators' feedback on the expected model-based rate for Malta *vis-a-vis* its European counterparts, the MCA is of the opinion that the adjustment mechanism's purpose has been superseded with the use of the indicative target rates stated in the Comments Letter as described in Section 3.2 below. Nevertheless the Authority will keep monitoring the upcoming BEREC Snapshot reports as well as future notifications by Member States. In conclusion, the MCA differs with Vodafone's opinion that revisions in MTRs may disrupt the mobile industry. The MCA has always been committed to deploy efficient termination rates in the market and it will continue to do so by aligning the local rates with the new definition of efficient costs set out in the Recommendation.

3.1.3 Compliance with European Commission Recommendation

With regards to Melita's doubts on the MCA's commitment to comply with the Recommendation, as already laid out above, the MCA believes these doubts as being unfounded. The MCA has on various occasions reiterated its commitment to set a 'pure' LRIC rate based on its Fixed and Mobile Network models. However, given the scale of the projects, and the Authority's limited resources, their parallel development is not feasible. These logistical difficulties are also recognised in the Recommendation itself, which gives leeway to NRAs with limited resources to use alternative interim methodologies.

Linked to this issue, the MCA would also like to draw Melita's attention to the fact that as early as May 2010, in its interconnection strategy, the Authority disclosed its plan to use a benchmarking methodology until the models were finalised. As stated therein, the MCA will however make sure that the results obtained from this methodology will be fully in line with the principles and guidelines of the Recommendation. In this respect, the MCA proposed interim rates that are within the EU average even when considering rates set by 'pure' LRIC countries during 2012.

With respect to Melita's reservations in connection with the lack of revision to the FTR, the MCA would like to clarify that Malta's FTR is already based on a long run incremental cost model (LRAIC+) based on the best practices prevailing prior to the deadlines of the Recommendation. Hence, barring a structural change in the methodology (as that brought about by the Recommendation) the FTR should remain at its current level; except for revisions to some ancillary input variables such as the WACC rate. Hence the stability of the FTR is technically sound.

Going forward, in compliance with the Recommendation, the MCA is confident that it will finalise its 'pure' LRIC model in time to have the FTR rate based on this methodology by the end of 2012. The commencement of this work stream had already been announced in the MCA's annual business plan and the Authority will be issuing the appropriate public consultation with the model's output, including the FTR.

In so far as Vodafone's comment on the benefit of lower MTRs not passing through to customers at the retail level, and without going into the merits of the accuracy of such a statement, the MCA would like to point out that the scope of this decision is restricted to the setting of efficient MTRs and hence its pass-through to retail services is a different matter. Indeed such a discussion forms part of the market analysis process which amongst others things, gauges the level of competitive constraints on retail rates. This analysis typically also takes into consideration the indirect pressure that should be exerted on fixed-to-mobile calls from mobile-to-mobile calls and any relevant substitution effects there from.

3.2 Response received from the EU Commission

With regard to the comments made by the Commission on the sources and methodology used by the MCA, after taking utmost account of these comments, the

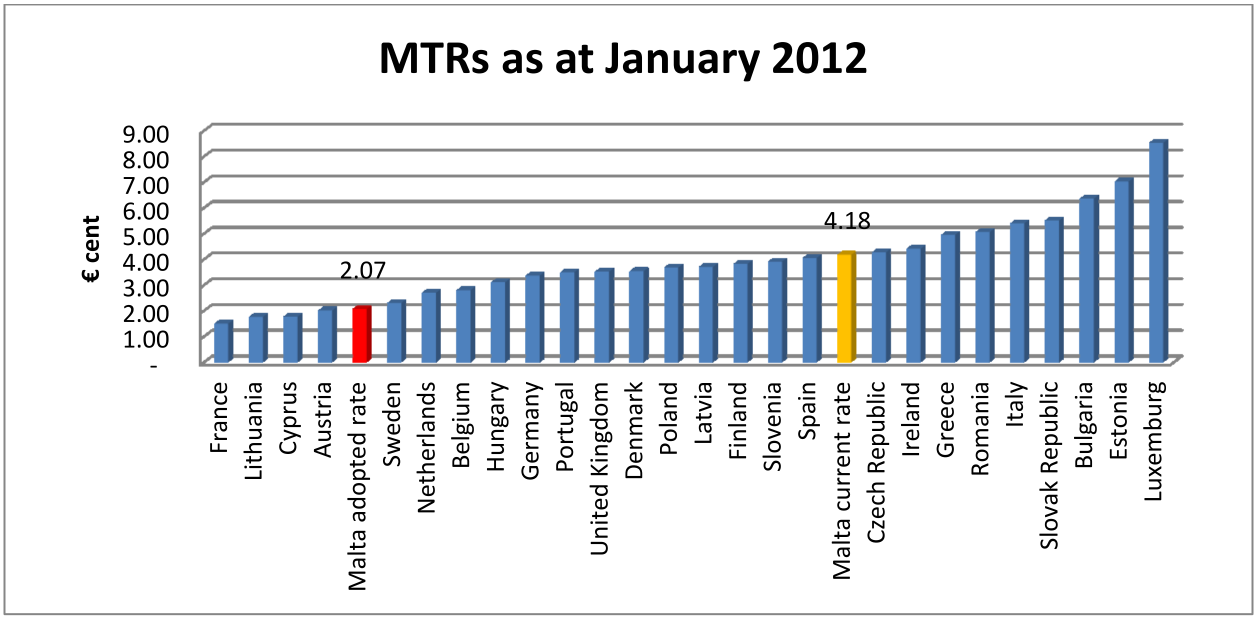
MCA will be replacing the BEREC Snapshot Report with the notified rates (see Appendix 1) contained in the Commission's Comment Letter as the basis for computing a revised indicative target rate.

As explained in Section 3.1.1 above this change in source was motivated by the fact that the Commission's comments letter is in itself an official source of information and hence fulfilling the pre-requisites of an adequate source, with the added advantage of containing more timely data. This notwithstanding the MCA still stands behind it's initial position to use the BEREC Snapshot report, since this is also a reliable and consistent source of information.

After taking into account the updated information included by the Commission, the indicative target rate is calculated at €1.03 cents and the interim rate is calculated at €2.07 cents (see Appendix 1). The interim rate of €2.07 cents for July 2012 is intended to be finally replaced by the Maltese 'pure' BU-LRIC model.

The MCA has also considered the Commission's views that the indicative target rate would be used as its benchmark rate and introduced at the latest by January 2013. The MCA has strong reservations in that it notes that other Member States (Italy, UK, Spain), who unlike Malta, have already developed their bottom-up models and hence know a priori their respective target rate, have nonetheless, and for very valid reasons also valid in the present circumstances, set a glide path which goes beyond January 2013. By this yardstick, the MCA therefore feels that the Commission's views in this regard should be interpreted in the light of the Decisions notified by other NRAs, even more so because the Recommendation itself accommodates interim measures that go beyond January 2013, given exceptional circumstances of small NRAs with limited resources.

Given the uncertainty surrounding the unique characteristics of a small market such as that of Malta and as witnessed by the feedback of the local operators, using the indicative target rate rather than an interim rate would risk undershooting the cost-oriented rate resulting from the eventual model. Put differently, the indicative target rate of €1.03 cents, being an average of the other Member States 'pure' LRIC rates, might result in a lower rate than the rate established from the Maltese 'pure' BU-LRIC model as in the case of the Netherlands (target rate of €1.2 cents) and Portugal (target rate of €1.27 cents).



Graph 2 – Adopted MTR rate and Current MTR rate as compared to the MTR rates of the Member States as at January 2012 disclosed in the BEREC MTR Snapshot Report.

As evidenced by the chart above, the interim rate of €2.07 cents represents a significant reduction which meets the objectives of the Termination Rates Recommendation. The reduction of 50% will ensure that the benefits of lower MTRs will be brought to consumers more quickly and in advance of the deadline in the Termination Rates Recommendation, as called upon by the Commission.

4 MCA's Decision on Mobile Termination Rate

After taking into account the feedback received during the consultation period, including that of the Commission, and the reasons explained in Section 3 above, the indicative target rate will be revised and based on the data featured in the Commission's Comments Letter in order to calculate the interim MTR. Basing on this information, as shown in Appendix 1, the revised indicative target rate is calculated at €1.03 cents, with a derived equidistant[4] interim rate of €2.07 cents. As also explained in Section 3, the adjustment mechanisms proposed in the consultation document of March 2012 is being superseded by the more timely reference rates featured in the Commission's Comment Letter whilst the interim rate is planned to be in effect until the rate from the Maltese 'pure' BU-LRIC model is established within the first six months of 2013, subject to unplanned procurement delays outside the control of MCA.

4.1 MCA Decision

Decision:

The MCA directs that all operators having been designated with an SMP status in the provision of the mobile termination services market shall apply €2.07 cents as their mobile termination rate with effect from 1st July 2012. This rate is to remain in force until it is replaced by the termination rate emanating from the MCA's BU-LRIC model.

Ing. Philip Micallef

Chairman Malta Communications Authority

[4] The interim rate represents a constant rate of decline, of approximately 50% between the two glide path points.

APPENDIX 1: Computation of indicative target MTR according to the list provided in the European Commission's Comments letter

The following rates were based on information obtained from the Comments letter by the European Commission. The list below includes those European Member States that have calculated a 'pure' LRIC rate and have notified to the Commission to date:

Country	Target rate € cents	Deadline
Netherlands (i)	1.20	01/09/2012
Belgium	1.08	01/01/2013
France	0.80	01/01/2013
Portugal	1.27	01/01/2013
Italy	0.98	01/07/2013
Spain	1.09	01/07/2013
UK (ii)	0.81	01/04/2014
Average MTR based on 'pure' LRIC	1.03	

Source: "Commission decision concerning Case MT/2012/1330: Voice call termination on individual mobile networks in Malta. Comments pursuant to Article 7(3) of the Directive 2002/21/EC"

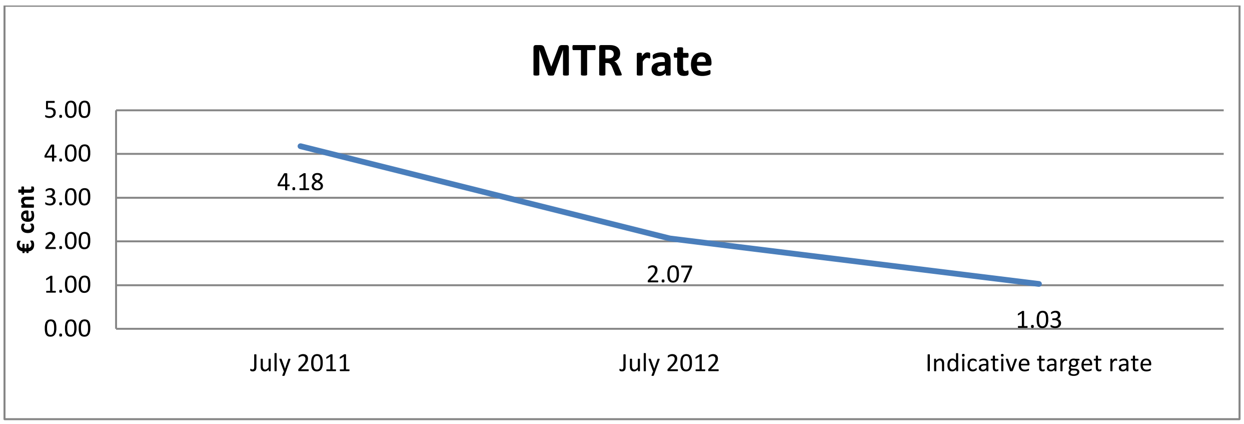
Notes:

i) OPTA renotified MTR remedies following a national court judgement requiring MTRs to be set according to a different ost model, resulting in a target rate of €2.4 cents per minute.

ii) Adopted rate. The UK's Competition Commission, by decision of 9 February 2012, endorsed Ofcom's use of a BU-LRIC cost model but asked Ofcom to shorten the glide path by one year (with a new target date of 1 April 2013).

APPENDIX 1 (continued)

The interim rate represents a constant rate of change between (approximately 50%) the current MTR and the indicative target rate, the resulting interim rate was calculated at €2.07 cents.



Graph 3 – July 2012 rate AS compared to previous rate and indicative target rate.