



# Mobile termination rate regulation in Ukraine

Analysis and recommendations for the NCCR

July 2009

# Introduction

Frontier Economics conducted a review of the mobile termination regime in Ukraine. This review focuses on the following aspects:

- A review of the current interconnection regime in Ukraine
- Prevailing regimes and best practice regulation in other jurisdictions
- A 'roadmap' for the implementation of desirable changes to the current Ukrainian regime

As part of our review we have applied a range of research methods, including:

- Stakeholder interviews
- Desk based research
- Review of international best practice

This presentation provides a summary of our report to the NCCR, highlighting our key findings and recommendations.

# There are ongoing discussions in Ukraine over the framework for setting termination rates at the appropriate levels

## Institutional setting

- Two key institutions are involved in termination rate setting:
  - The Antimonopoly Committee (AMC) defines monopolists
  - The National Commission for Communication Regulation (NCCR) regulates monopolistic telecoms operators

## Level of termination rates

- Existing termination rates were partly determined by regulation or based on bilateral negotiations:
  - As a consequence of being defined as a monopolist operator, all Ukrtelekom's termination rates are set by the NCCR
  - All other termination rates are the outcome of commercial negotiations

Service	Rate (Kopeks per minute)
<b>Fixed termination</b>	
Fixed-to-Fixed (F2F) calls - Ukrtelecom	1.50
F2F calls - Other operators	1.00
Mobile-to-Fixed (M2F) calls	25.00
<b>Mobile termination</b>	
Fixed-to-Mobile (F2M) calls	50.00
Mobile-to-Mobile (M2M) calls	50.00

## Fixed and mobile operators have been declared dominant in termination services

The AMC has recently declared all operators dominant in termination services

- In May 2009, the AMC has concluded its review of termination markets in Ukraine
- Based on its analysis, it has ruled that all fixed and mobile operators are monopolists in their relevant termination markets
- We understand that in June 2009, the implementation of AMC's ruling has been postponed following legal challenge

The AMC's ruling would allow the NCCR to review its termination rate regulation regime

- Given its mandate, the NCCR was asked by AMC to review the current termination rate regulation
- In case the AMC's ruling is upheld, a revised regime should be in place by early 2010

These developments provide the context for our review.

# Focus of this presentation

## 1) Brief overview of international practice in termination rate regulation

- During our last meeting with the NCCR, we discussed in detail the regulatory experiences across other European countries.
- This presentation contains a brief re-cap of the key issues. More details are presented in our report.

## 2) Comparison of current termination rate regime in Ukraine to regimes in other countries

- In particular, we assess two elements:
  - The institutional structure of the current regime
  - The levels of termination rates

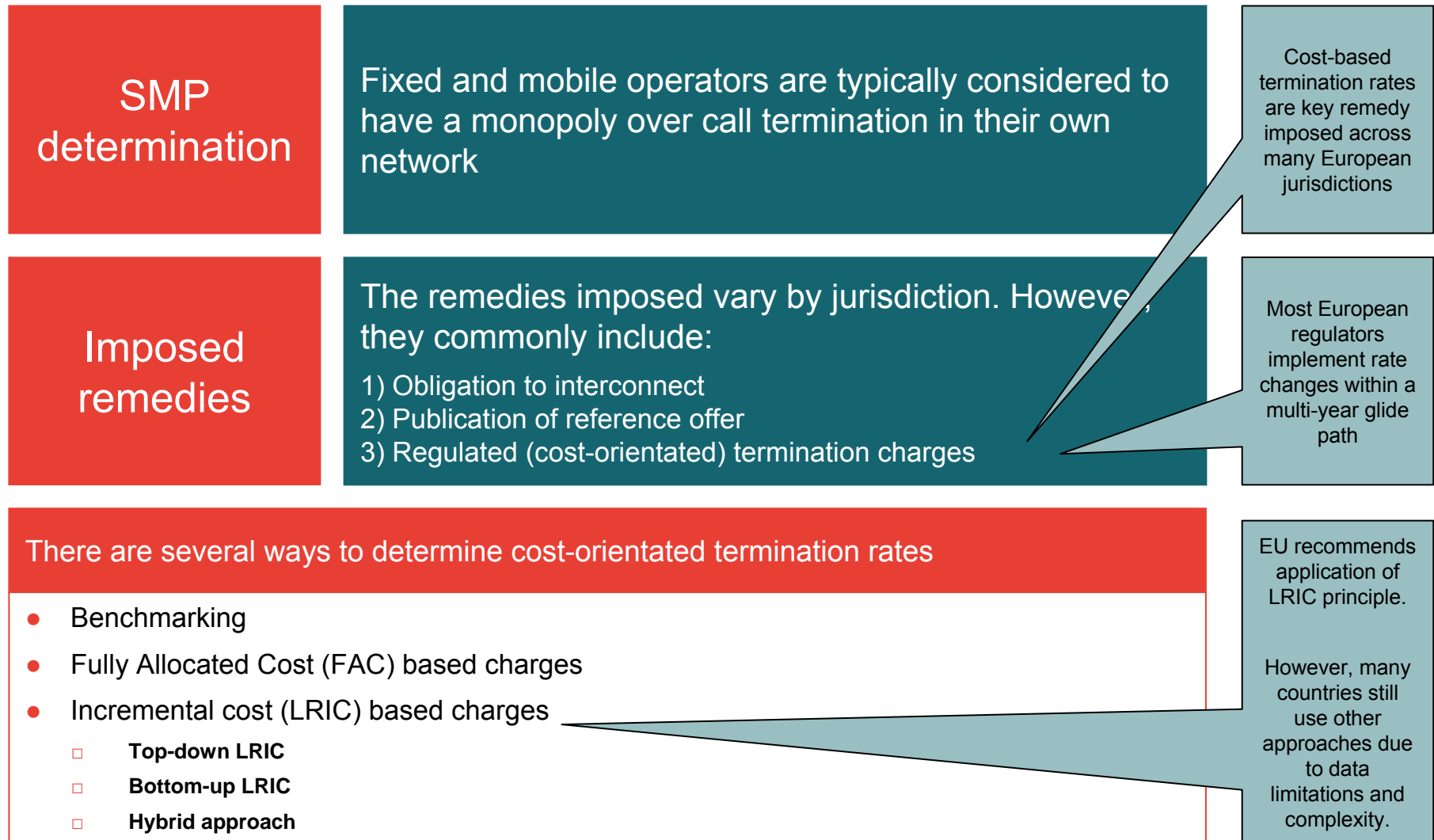
## 3) Recommendations for changes to the Ukrainian regime

- Lessons from best practice elsewhere
- A proposed roadmap

This presentation does not cover a detailed discussion on implementing our recommendations. We propose a separate workshop with the NCCR on this.

- International practice
- Current regime
- Key recommendations

# Most European fixed and mobile operators face regulated (cost-based) termination charges



- International practice
- Current regime
- Key recommendations

# Ukrainian institutional structure

## Regulatory rationale

- Interconnection regulation currently only imposed on monopolistic operator
- Lack of transparency of AMC's approach on market definition and market power
- No periodic review of the decisions of whether an operator is a monopolist

## Division of responsibilities between AMC and NCCR

- Current legislation only allows NCCR to impose interconnection regulation once operators are determined to be monopolists [by AMC]

# Termination rates

## Current termination rates may require adjustments

- Current regulation stipulates that termination rates of monopolistic operators should be cost orientated
- Not clear if current rates reflect cost
- Current rates have not been reviewed for several years
- Current rates seem out of line compared to the rest of Europe



	Mobile termination rates (MTRs)	Fixed termination rates (FTRs) *	MTR:FTR ratio
Ukraine	€c 6.49 per minute	€c 3.24 per minute	2.00
European average**	€c 8.36 per minute	€c 1.04 per minute; €c 1.40 per minute	6.74; 9.34

\* Fixed termination rates reported in this table relate to long distance fixed calls

\*\*The two sample averages reported for fixed termination rates and MTR: FTR ratios resemble single and double tandem fixed termination rates, respectively

- International practice
- Current regime
- Key recommendations

# Our recommendations cover all aspects of the termination rate regime

## Institutional setting

- Introduce the concept of SMP more in line with EU definitions
- NCCR (subject to coordination with the AMC)
  - to determine dominance/SMP in telecoms markets; and
  - to impose remedies based on the outcome of periodic, independent market reviews
- AMC
  - to retain ex-post competition investigation powers

## Market review

- NCCR to undertake market reviews of all markets and align its remedies according to the outcome of the reviews
- Market reviews should be transparent, independent and conducted on regular basis
- NCCR to apply the same approach to setting fixed and mobile termination rates; whilst allowing for potential cost differences

A possible conclusion from the market review could be that it might be more desirable to allow for bilateral negotiations on termination rates for at least some operators. The NCCR would then take on a dispute resolution and appeals body role.

# Our recommendations cover all aspects of the termination rate regime

## Termination rate setting

- If the EU approach is adopted, NCCR should introduce cost orientated termination rates based on detailed cost studies
- NCCR to consider applying a two-stage approach, with charges initially based on less complex methodologies (e.g. FAC based approach)
- To ensure the best possible outcome, NCCR should draw on international experience and expertise
- NCCR to implement any rate changes within a multi year glide path
- Fixed interconnection rates should not include mark-ups for contributions towards access deficit costs

# Introducing cost orientated termination rates can be a complex and resource intensive

An Interim termination regime could be implemented based on three steps:



A permanent termination regime could be implemented based on the following steps:



# The implementation is likely to take time

## Implementation

- An interim regime can be put in place within a year
- The cost modelling analysis can start whilst the interim regime is in place

## The exact time line will depend on:

- Choice of cost modelling approach
- Availability of data
- Required length of the glide path
- Degree of public consultation within the process

# We propose a separate implementation workshop with NCCR

The workshop would cover the key steps during the implementation of the preferred approach

- The three costing approaches covered could include:
  - FAC modelling
  - Top-down LRIC modelling
  - Bottom LRIC modelling
- For each approach, we propose to discuss:
  - Overview of the modelling approach
  - Common data requirements
  - Key methodological issues (incl. advantages and disadvantages compared to alternative approaches)
  - Possible implementation steps and timings

We propose holding a one day workshop, with the timing to be discussed with the NCCR.

ANNEX:

Best practice regulation

# Any regulatory intervention requires a clear rationale...

## Why regulate a liberalised market?

- Core objective of market liberalisation is to allow market forces to determine prices and quality of telecommunications services
- Regulatory intervention can be desirable where competition cannot be considered sufficient to discipline the behaviour of market players – i.e. existence of market failures prevent efficient outcome.

## How to best regulate?

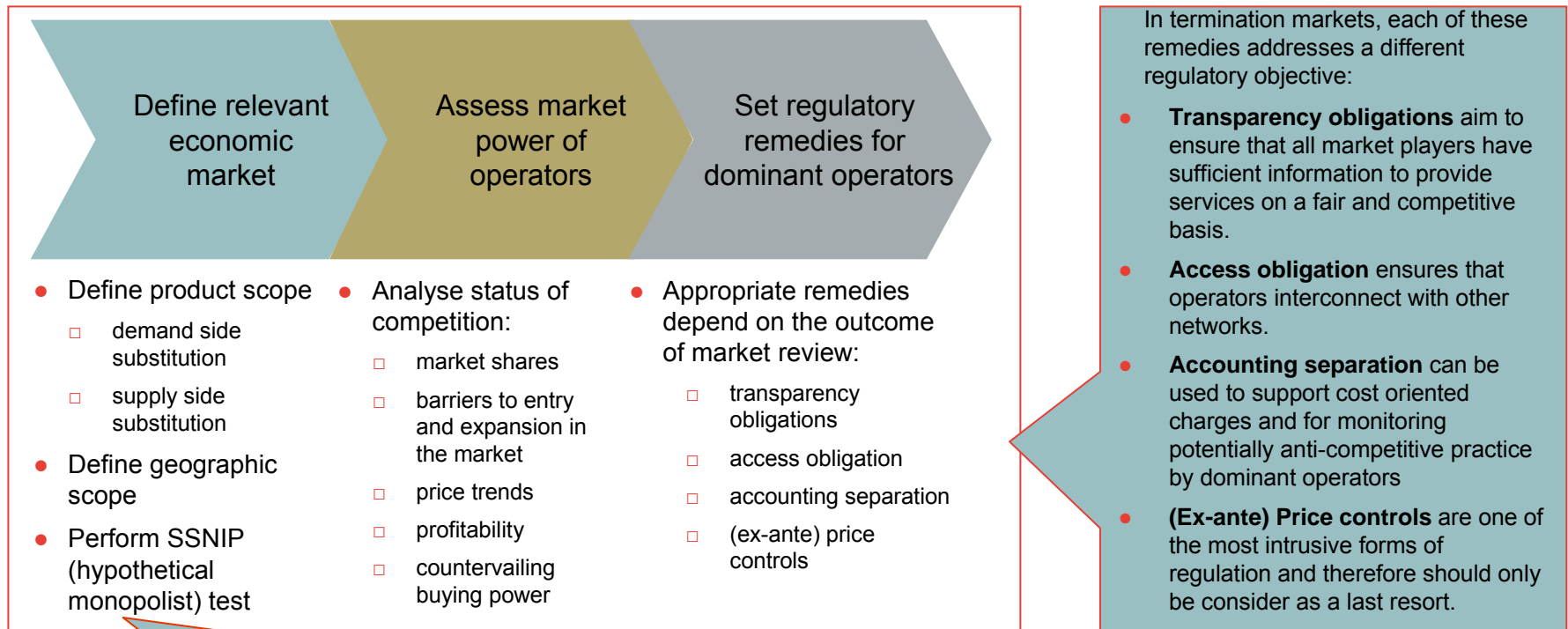
- When intervening, regulatory authorities need to select regulatory instruments that deal effectively and in a proportionate way with the market failure identified.
- Determining the most appropriate tool requires a good understanding of the underlying market environment. This is best achieved by undertaking a market review process.
- Regulation should be independent and evidence-based

## Whom to regulate?

- The market reviews will identify the dominant operators in each relevant market.
- Any regulatory intervention should only be applied to dominant operators.

...market reviews provide answers to all the above questions.

# The European framework for imposing ex ante regulation is based on a three step market review process...



The SSNIP (“**S**mall but **S**ignificant **N**on-**T**ransitory **I**ncrease in **P**rice”) test is the most common approach within the EU to market definition. It identifies products which are close substitutes and hence which could be said to compete in the same market.

Periodic market reviews ensure that regulation is only imposed on dominant operators.

# Fixed and mobile operators are typically considered to have a monopoly over call termination in their own network

## Market reviews have led to SMP determination in all call termination markets

- Most market reviews have defined call termination on individual (mobile and fixed) networks as the relevant economic market
  - No service provider can terminate calls on another operator's network without its consent.
  - Consumers show a low sensitivity to the price for call termination.
- Consequently, each operator has been deemed to have significant market power on terminating calls on its network

## Imposed remedies

- The remedies imposed vary by jurisdiction; however they commonly include:
  - Obligation to interconnect
  - Publication of reference offer
  - Regulated (cost-orientated) termination charges

Cost-based termination rates are a key remedy commonly imposed across all European jurisdictions. This is in line with economic theory on efficient (i.e. welfare maximising) pricing.

**Note:** In Europe, mobile termination rates were set after fixed termination was regulated at cost. If rates can be set simultaneously, it is possible that countervailing buying power could reduce, or potentially remove, the ability of any individual operator to behave like a 'monopolist' on its own termination market.

# There are several ways to determine cost orientated termination rates

<b>Benchmarking</b>	<p>Simple method establishing termination rates based on those experienced in other countries. It is particularly useful when there is not detailed cost data. In benchmarking exercises it is important to:</p> <ul style="list-style-type: none"><li>• consider only the rates of the comparable jurisdictions; and,</li><li>• make necessary adjustments in terms of exchange rates, traffic patterns, etc. so that the data is comparable.</li></ul>
<b>Fully Allocated cost (FAC) based charges</b>	<p>Method determining cost-oriented termination rates based on operators' fully allocated average costs (FAC). The required (historic) cost data often builds on operators' management accounting information, allocating all costs to services.</p>
<b>Incremental cost (LRIC) based charges</b>	<p>Method determining cost-oriented termination rates based on operators' long-run incremental costs (LRIC) or LRIC plus a mark-up for recovery of fixed and common costs (LRIC+). LRIC is the cost of providing an extra increment / cost saved by not providing the increment. There are two main LRIC modelling approaches:</p> <ul style="list-style-type: none"><li>• Bottom-up. This approach estimates the cost that a reasonably efficient hypothetical operator would incur in providing termination services. This requires detailed data to build a hypothetical network that offers termination services. The costs of this network, including capital costs and operations and maintenance costs, are then allocated to all the services provided.</li><li>• Top-down. In contrast, a top-down approach estimates LRIC based on existing operators' actual costs.</li></ul> <p>LRIC modelling can proxy marginal costs , but can be significantly more complex to implement than FAC modelling.</p>

The EC recommends the application of LRIC principle. However, many countries in the EU and elsewhere still use the other two methods due to data limitations and complexity of LRIC estimation.



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