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Date: 18th May, 2011

Dr. J.S.Sarma
Hon'ble Chairman,
Telecom Regulatory Authority of India,
Mahanagar Doorsanchar Bhawan,
Jawahar Lal Nehru Marg,
New Delhi – 110002

Sub.: ACTO's Response to TRAI Consultation Paper (No.4/2011) on Review of Interconnection Usage Charges (IUC)

Dear Sir,

With reference to above, we wish to submit our response to TRAI Consultation Paper on 'Review of Interconnection Usage charge (IUC)' issued by the Hon'ble Authority.

We hope that our submissions will merit for your kind consideration and provide us an opportunity to contribute further in your OHD on the subject.

Thanking you, With kind regards,
Respectfully submitted,

Satya N Gupta
President
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Encl:A/A
C.C.:
Shri R. Ashok, Member -TRAI
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<u>ACTO's Response to TRAI Consultation Paper on Review of Interconnection Usage Charges dated 27th April 2011.</u>

1. At the outset, ACTO warmly compliments the Hon'ble Authority for initiating consultation process for review of Interconnect Usage charges, which have direct bearing on the overall growth of telecom sector in the country and has potential to initiate the regulatory framework to enable the next generation data and access services.

2. Interconnection is crucial for communicating across all networks, and is essential for extending the scope and efficiency of the telecom network. It is especially important for new operators entering the market who generally use the existing facilities of another operator for providing their services to end users. It is therefore fundamental to a competitive market structure. Interconnection involves a linking up of one telecom operator to the infrastructure facilities of another.

3. The World Trade Organization(WTO) defines interconnection as:

   Linking with suppliers providing public telecommunications transport networks or services in order to allow the users of one supplier to communicate with users of another supplier and to access services provided by another supplier, where specific commitments are undertaken.

4. As technology has changed and competition has intensified, many forms of interconnection have developed. All involve the linking of networks to enable customers of one network to communicate with customers of another network or to have access to services offered

by another network operator. With the passage of time, the IUC regime per se has also come of age. With the advent of next generation technology and other IP based services, it is important that other forms / facets of interconnection beyond voice such as data (IPLC / DLC / Last Mile Access) are also given due recognition in this exercise of review of interconnection regime and the same may be reviewed on a periodical basis. These are links which also help in establishing interconnection in the data space which is now an emerging sector. Therefore IUC should include charges paid for IPLC/DLC/Local Access for providing services riding on data networks and other emerging technologies. The past TTO's in this respect were last announced in the year 2005. Therefore the time is ripe for a periodic review and inclusion of such an important and significant IUC component to promote competition and ensure level playing field in the market

5. It is to be appreciated that the objective of interconnection pricing policy should be similar to National Telecom Policy (NTP) and considered for the growth of tele-density, investment policy, profitability of the sector, level of competition and telecom tariffs etc in the country. This is particularly relevant because of the link between interconnection and the provision of telecom services to end users. Meeting the objective of efficient provision of services to end-users would necessary need the efficiency enhancement of different telecom operators. Interconnection Charges that are based on costs provide a motivation for efficient operation and justified charges to end users. For ensuring efficiency, costs which form the basis of interconnection charges should be bare necessary (or efficient/incremental) to be incurred in the long run (i.e.

Marginal cost under forward looking approach) to provide the service.

6. The Hon'ble Authority has very rightly noted (Para 3.10) that excessive prices can provide dominant firms with revenues which they can use for predatory pricing or cross-subsidising selective services in an effort to drive competitors out of the market. The incumbents, generally want to protect their market share while new competitors need to establish profitable market presence. The outcome of the interconnection pricing decisions goes a long way toward determining how successful different telecom operators will be in achieving those goals.

7. We would like to urge that the Hon'ble Authority may take into account our above basic submissions while considering the issues raised in the present consultation.

Issues for Consultation

Q1. Do you agree that the IUC regime determined through this consultative process should be applicable for 3 years? If not please indicate your preferred time period with justification.

No, we believe that the IUC have direct impact on telecom tariffs & especially on access segment and presently Access segment is contributing about 78% of total revenue of Indian telecom service sector. It is also important that IUC constitutes about more than 40% of revenue realized per minute of access services. As the technology as well as the network costs are changing very dynamically, we believe that timely periodical review of IUC regime which duly aligns with such technological changes of charges with current cost of telecom network and minutes of Usage and will further help to service providers to offer more innovative tariff plans to consumers..

Q2. Keeping in view the time period indicated by you in question 1, which of the following approaches would be most appropriate for the Indian telecom sector?

(a) Cost oriented or cost based;

(b) Bill and Keep;

Please provide justification in support of your answer. In case you feel that the approach should vary according to service, please explain why?

Generally accepted regulatory best practices worldwide indicate that there is a consensus among telecom operators and regulators that interconnection prices based on cost orientation are most likely to lead to desirable and acceptable outcomes.

We have also noted that since 1997, the Hon'ble Authority by itself has advocated for cost oriented / cost based pricing for telecom services. In the various previous telecom tariff/price fixation exercise, the Authority has used cost oriented approach.

Bill and keep (BAK) approach applies to two-way interconnection. Under this approach, the calling party's network retains whatever revenue it raises through retail usage charges. Neither the calling nor receiving parties' networks pay each other; the interconnection charge is effectively zero. One advantage of a bill and keep policy is that it can be adopted quickly without the need to employ a cost analysis. It is normally used when there is a symmetry in the traffic flow trend among the operators. This could be useful in the situation of a small, developing country needing an interim policy to facilitate interconnection between competitors while developing a policy based on cost analysis.

In view of above facts and analysis, we believe that under the present circumstances of telecom service sector in India, cost oriented/cost based approach (i.e. incremental cost) would be appropriate.

Q3. In case your answer to question 2 above favours the cost oriented approach, would it be appropriate to permit Bill and Keep between service providers who have symmetric traffic?

Though, it is good idea to permit Bill-and –Keep in case of symmetric traffic, it will be difficult to administer and will call for differential regulatory approach by the regulator. Therefore, it is suggested that the proposed approach may be applicable across the telecom service industry.

Q4. If the cost-oriented or cost based approach is used for Interconnection Usage Charges, do you agree that fully allocated cost can be used with historical cost data submitted by various service providers in their audited Accounting Separation reports, published documents or any other information submitted to TRAI? If not, please give your alternate solution with explanation, required data and proper justification.

We believe that the fully allocated cost (FAC) approach with historical cost data under present accounting separation reports is backward looking approach and it is generally applicable in the initial stage of telecom pricing.

It is important to note that the present Accounting Separation framework was devised in 2000[1], based on mainly inputs of PSUs telecom Operators (DoT/BSNL, MTNL and VSNL). Since 2000 to 2011, there have been significant changes in the telecom service industry and most of the Private telecom service providers have changed their business model (From CAPEX Model to OPEX

[1] However it is implemented in 2002/2004, through Rules (TRAI service provider (Maintenance of Books and accounts and other Documents) Rules 2002 and Regulation (Reporting system on Accounting Separation Regulation 2004).

Model), they have become know integrated vertical telecom service providers.

The present Accounting separation framework does not provide the information about the Long Run Incremental Cost (LRIC) of services/products/network services, cross subsidy, predatory pricing and whether interrelated party transactions have been carried out at arm length prices in the prescribed formats; however, these were objectives of accounting separation framework. **Therefore, we believe that the costing data collected under the present Accounting Separation Reports can not be utilized for determination of Interconnect Usage charges/wholesale network services.**

Q5. Should CAPEX be included in calculating/ estimating termination charge? If so, which network elements from the ASR data should be included in the cost base?

We believe that the Hon'ble Authority should consider only the Directly Attributable Incremental cost for termination charge/Interconnect usage charge as indicated in our earlier responses. All the costs which has the opportunity to be recovered through origination charge should not be considered for termination charges. The main principle to be used should be that all the costs need to be recovered only once through different avenues of origination, transit and termination without considering any cost more than once.

Since the present accounting separation regime does not work on incremental cost principles, therefore, it should not be utilized for determination of termination charge.

Q6. Do you agree that with inclusion of CAPEX in the calculation of termination charges, rental/ administrative or any other fixed charge component should be removed from the retail tariff by regulatory intervention? If not, please give reasons.

We believe that the Hon'ble Authority should not allow the operators to recover any double costs which have been already covered through any means/ products/ network services. We further recommend that operators may be allowed to recover only efficient costs under competitive environment.

We believe that in a competitive environment as in India, prices/charges should be set on the basis of the prevailing technology and operators should compete on the basis of current costs and not be compensated for costs incurred through inefficiency; neither should high-cost operators be allowed through regulation to pass on their inefficiencies to final consumers.

Q7. Should TRAI continue with the existing rate of return of around 15% in the form of pre tax WACC as adopted in other regulations? If you do not agree with the above, please state what should be the rate of pretax WACC, along with justification for your proposed rate.

We believe that WACC should be at level, which may compensate the opportunity cost of the industry investment in the network services and further encourage the more new investment in the industry. Since, over the period (2003 to 2010), the Hon'ble Authority has fixed a range of WACC, starting from 12.21% to 15% in various costing exercises of telecom network services. These WACC are generally based on PSU's capital structures (BSNL/MNTL/VSNL), therefore, it is necessary it may be reviewed under the present circumstances and capital structures of private telecom companies.

We have noted that in other jurisdictions, regulators are generally conducting full fledge consultation on determination of cost of capital for the industry or incumbent operators for telecom pricing. In the recent past, UK Telecom regulator Ofcom has published consultation paper on "Ofcom's approach to estimating companies' weighted average cost of capital", it is available on its website2 and similar exercises were also carried out by other telecom regulators of Ireland (Comreg)3, Australia, UAE and Malaysian telecom regulator etc.

2

http://stakeholders.ofcom.org.uk/binaries/consultations/cost_capital/summary/cost_capital.pdf

3

http://www.comreg.ie/publications/response_to_consultation_and_decision_notice_d01_08_-_eircom_s_cost_of_capital.506.103091.p.html

Q8. Would it be appropriate to adopt Straight Line Method with an average life of 10 years for all network elements for taking into account depreciation? If you do not agree with this proposal, please give your alternative method with justification.

As we are aware that due to the capital-intensive nature of telecommunications industry, depreciation plays a significant role, the most important factors influencing decreases in value are wear and tear through usage and the shortening of theoretical asset life through the development of newer, more efficient technologies. Depreciation refers to a change in the economic value of assets over time. The economic value of an asset in any year is equal to the present value of the expected future revenue of output over the life of the asset, minus the present value of the operating costs associated with running the asset.

We believe that in the present competitive environment of India, the <u>Economic depreciation approach</u> would be most appropriate for asset depreciation wherever feasible and considered appropriate.

Q9. Do you agree with the proposal for treatment of the cost items as indicated in Table 3.2? If not, please give your proposal with justification.

Please refer to Q.No.2&6

Q10. Do you agree that revenue can be used as a driver for segregating the cost pertaining to VAS services from the total

cost indicated in the ASRs? If not, please provide a template with appropriate method for separating the cost items for value added services from the cost data provided in the ASR.

We believe that costs of Value added services should be segregated generally based on their network utilization or Activity based costing.