VIL/LT/13-14/535
9th December 2013

Telecom Regulatory Authority of India
Mahanagar Doorsanchar Bhawan
Jawahar Lal Nehru Marg,
New Delhi-110002

Kind Attention:	**Shri Arvind Kumar, Advisor (NSL)**
Subject:	**Consultation Paper on Revenue sharing arrangements for calling Card Services**
Reference:	**Consultation Paper No.10/2013**

Dear Sir,

This is with reference to the consultation paper issued by the Authority on 14th November 2013 on the captioned subject.

We are pleased to submit our comments and views on the Consultation paper on 'Revenue sharing arrangements for calling Card Services'.

As informed in our earlier submissions we have signed the agreements with four operators and we are in an advance stage of negotiation with another four operators, which we would inform the Authority immediately on conclusion.

We would like to mention that we are enclosing two versions of our response as follows:

1. **Confidential Version (Annex-I)**-For TRAI's internal consumption
2. **Non-Confidential version (Annex-II)**-for putting up **on TRAI Website**

We hope our submissions will merit your kind consideration.

Thanking you

Yours faithfully,
For **Vodafone India Limited**

Manish Gupta
General Manager- Regulatory Affairs
9811919550

Enclosed:

(i) **Annexure –I-Confidential Version** of VIL's response on Calling Cards
(ii) **Annexure-II-Non-Confidential Version** of VIL's response on calling Cards

Annexure-II

Non-Confidential

Revenue Sharing Arrangements for Calling Card Services

Summary

Vodafone does not believe that the kind of intervention proposed by the TRAI is either justified or warranted. Ten vertically integrated operators compete to offer customers local, STD and ISD calls. Prices for all services have declined over time; and those consumers that are particularly sensitive to the cost of long distance and international calls can *already* purchase calling cards and special tariff vouchers to reduce their outlay. In fact, more than a [confidential] of STD calls, and a [confidential] of ISD minutes, are charged at a discount to the standard rate. The differential growth rates of outbound versus inbound international minutes—the only reason given by the TRAI for its proposed intervention—is best explained by the substitution of VoIP data 'calls' for metered per minute voice calling; this trend will be left unaffected by regulating the revenue sharing arrangements for calling cards.

TRAI has not considered the potential revenue impact of its proposed intervention. However, if the price of calling is reduced—as it appears to intend—the loss of revenue could be as high as Rs. 2,250 crores across the industry. In response, operators will try to make up for this by rebalancing prices and increasing the cost of local calls; if unsuccessful, they will be less inclined to invest in customers, or sites, because the profitability of doing both will fall.

If TSPs are struggling to fix commercial terms, the TRAI should do no more than indicate the pricing principles that it would apply if it were required to set the access arrangements: 'retail-minus'. This rule ensures that any new competitor has to do something 'better' than the access provider in order to 'get the business' and that *both* parties to the agreement will benefit; this is typical of any freely negotiated commercial arrangement. This approach was used by the only regulator—Oftel in 1999— that we have found that has sought to impose this type of mandated access upon mobile operators.

We urge the TRAI not to set an access charge on the basis of 'work done'. It cannot simply "prescribe equal to termination charge" because our MTC does not include capital costs and therefore it does not capture the cost of the 'work done'. Any fee levied by a TSP for access to its customers must allow it to recover its capital costs, common costs and retail costs. The latter are recovered from outbound call charges, they are not 'saved' under this kind of access arrangement, and therefore they must be recovered from calls that are passed to calling card providers. If TSPs cannot earn a fair return of the activity of their customers they will be less inclined to acquire them and invest in the networks which support them.

In the section below we set out the case against regulating the revenue share arrangements for calling card services. We argue that TRAI should do no more than endorse a 'retail minus' pricing principle for the commercial terms between operators. Importantly, any charge must recompense the access provider for its capital costs, retail costs and a share of its common costs. To do otherwise would undermine the incentive of the access provider to invest in its network and add customers.

In the later section we answer TRAI's individual questions.

There is no 'market failure' which requires regulatory intervention

The consultation paper implies that competition is not working well in the supply of both STD and ISD calls. The evidence however shows the opposite.

There are ten vertically integrated access, NLD and ILD operators—between six and nine in each circle—with an 11th (Reliance Jio) which is expected to enter the market next year. Barring one operator, no access provider is without its own STD and ISD capability. Switching barriers between operators are low: the vast majority of customers are not tied to any form of contract and they can port their number between operators within a week. Contrary to the view expressed in the consultation paper, customers do "have a real choice by picking and ILD carrier which offers the most competitive tariff for ILD calls".[1]

The integrated providers *also* offer services designed for those customers concerned about the price of STD and ISD calls:

- At least seven operators—Aircel, Airtel, BSNL, MTNL, Reliance, Tata and Vodafone—provide a calling cards to their customers.[2] As the TRAI noted in its press release which accompanied its modifications to national roaming prices: "TRAI feels that the best way forward is to establish a tariff regime in which roamers self-select themselves out and so minimize the impact on the rest of the subscriber community." Likewise, a customer that is concerned about the price of national and international calling can 'self-select' and purchase a calling card. This feature of the market has occurred without the need for any intervention by the regulator.[3]

- Most operators offer STD and ISD Special Tariff Vouchers (STVs); these provide cheaper calling rates without the need for a cumbersome call initiation process typical of calling cards. Examples of Vodafone's STD and ILD STVs are shown below. **[confidential]**

ISD Bonus Cards (Vodafone examples)

[1] See paragraph 36 in the consultation

[2] Vodafone offers a World Calling Cards where customers can save up to 30% on ILD calls. For example, a customer talking a Rs. 550 card would pay Rs. 4.20 per minute for a call to the US.

[3] As the TRAI noted in its decision on the regulation of national roaming tariffs: "Regulatory forbearance in the matter of fixing tariff for flagship services such as voice calls and SMSs in the home service area has been an important factor in the remarkable growth of Indian telecommunications over the last decade." (see paragraph 10).

- Delhi Circle: Rs. 58 for an ISD bonus card with calls to Canada and USA at 1p/second with a validity of 25 days.
- Mumbai Circle: Recharge with Rs. 19 to get cheaper rates on ISD calling to Nepal and Bangladesh. All calls to Nepal at 12p/second and Bangladesh at 6p/second. Valid for 30 days

STD STVs (Vodafone examples)

MUMBAI		
MRP	**Benefits**	**Validity**
37	Get all STD Mobile to mobile calls @ 35P/Min. Valid For 30 Days.	30 Days
55	90 STD minutes, valid for 7 days	7 days
141	250 STD minutes, valid for 21 days	21 days

DELHI		
MRP	**Benefits**	**Validity**
19	All STD calls @ 50p/min	28
38	All STD calls @ 40p/min	28
68	All STD calls @ 40p/min	60
299	600 STD minutes valid for 30 days	30

Customers can already avail the STV and calling card services of *other* operators, either by switching their supplier or by using a dual SIM phone. We know that nearly half of Vodafone's customers use dual SIM phones and we estimate that 80% of these phones house two active SIMs. Furthermore, around 90% of the entry level smartphones shipped to India have a dual SIM capability; as the penetration of smartphones increases the proportion of customers with access to dual SIM phones will rise.

All of this competitive activity is manifested in the path of the *average* charges for STD and ISD services over time. In the table below we chart the decline in these charges over the last five years; a reduction of, on average 14% per annum for STD calls and 4% for ISD calls in nominal terms.[4] The data indicate that the market is competitive. Indeed, it is revealing that not a single NLD or ILD operator, of the over 30 that are operating within India, has approached Vodafone to negotiate an access agreement. This is compelling evidence that the market for these call types is competitive, that competition is disciplining prices and that new entrants have not spotted 'excess profit' in the supply of either service which they can exploit.

[4] These percentages become 21% and 11% in *real terms* per annum using an average inflation rate of 7%.

Year	STD - revenue per minute (Rs./min)	ISD - revenue per minute (Rs./min)[5]
09-10		
10-11		
11-12		
12-13		
13-14TillOct		

The only piece of evidence that the TRAI cites in support of its intervention is "..the fact that ILD outgoing minutes are not increasing at the same rate as ILD incoming minutes" (note that no argument is adduced in support of regulating the price of access for STD calls using calling cards). However, the TRAI makes no attempt to delve into *why* the growth of inbound calls differs from outbound and, in particular, why the number of outgoing ISD minutes has declined year-on-year since 2009/10.

The most obvious explanation is the substitution of metered voice services with VoIP calling. Customers with access to VoIP can make VoIP to VoIP calls for an incremental cost of zero on a data plan, compared with the average price of an ILD minute of Rs. 7.45[6]. Using a simple analysis of Skype's prices we can observe two effects:

- The price of a 'Skype Out' call to the UK (i.e., a call destined for a PSTN number in the UK) is typically more expensive than a call from India to the UK. For example, from the table below, a two minute call to a mobile in the UK will cost almost Rs. 11 per minute[7]. This compares with Rs. 4.20 per minute using a Vodafone calling card. This means that Indian citizens are likely to use 'Skype to Skype' (VoIP to VoIP) calls in order to save money on their international calling.

- In the reverse direction, a UK mobile phone user calling India will save money by making Skype to Skype calls and Skye Out calls. For example, the cost of a two minute call to an Indian mobile is around Rs. 5.80 per minute (see the table below). This compares with a charge of Rs. 150 per minute for calls to India on the Vodafone Red tariff plan.

The *consequence* of the above behavior of consumers is that the Skype Out calls into India show up in the incoming ISD minutes because they are interconnected with the PSTN/ILD operator at some point.[8] In contrast, the VoIP to VoIP calls originating in India do not show up in the outbound ISD minutes, instead they register as local consumption of data,

[5] Top 80% (by traffic) destinations
[6] See table 3 in the consultation
[7] We assume Rs. 100 = £1.
[8] There may also be another effect at work here: the transfer of economic activity in the form of call centres and BPO activities to India. This may, in part, explain the healthy increase of inbound calling into India.

indistinguishable from internet browsing. This provides a plausible explanation for why the international outbound and inbound minutes are growing at a differential rate. Indeed, the TRAI's own Performance Indicator report suggests there are over one billion minutes of internet telephony from ISPs alone.[9] Allowing STD/ISD operators with calling cards to access the customers of local service providers at regulated charges with not reverse the trend of outbound international calls. Put simply, Indian consumers of international calls are unlikely to switch *back* to metered voice calls *from* VoIP to VoIP calls which, with a data plan, may have an incremental charge of zero. Indeed, as the penetration of smartphones increases in India we can expect the volume of metered international calls to fall further year-on-year.

Skype Charges for calls to India and to the UK:

Pay As You Go - United Kingdom

Calling - per minute[1]	excl. VAT
United Kingdom[2]	1.4p
United Kingdom - London[2]	1.4p
United Kingdom - Mobile - Hutchison3G	14.9p
United Kingdom - Mobile - O2	14.9p
United Kingdom - Mobile - Orange	14.9p
United Kingdom - Mobile - Others	14.9p
United Kingdom - Mobile - T-Mobile	14.9p
United Kingdom - Mobile - Vodafone	14.9p
United Kingdom - Premium Airlines	90p
United Kingdom - Premium Customer Support	90p
United Kingdom - Premium International Consular	£1.10
United Kingdom - Premium UK Government Services	30p
United Kingdom - Shared Cost - 0844	7.00p
United Kingdom - Shared Cost - 0845	8p
United Kingdom - Shared Cost - 0870	11p
United Kingdom - Shared Cost - 0871	13.5p
United Kingdom - Shared Cost-0843	7.00p
United Kingdom - Shared cost - 0872	13.2p
United Kingdom - Toll Free[3]	0p

[1] A connection fee of 6.9p applies, unless otherwise indicated.
[2] A connection fee of 3.9p applies.
[3] A connection fee of 0p applies.

Pay As You Go - India

Calling - per minute[1]	excl. VAT
India	4.7p
India - Ahmedabad	4.7p
India - Bangalore	4.7p
India - Hyderabad	4.7p
India - Madras	4.7p
India - Mobile	4.7p
India - New Delhi	4.7p

[1] A connection fee of 6.9p applies, unless otherwise indicated.

TeleGeography[10] estimates that international call volumes increased by 23 billion minutes in 2012, to 490 million minutes (a 5% increase), while Skype's international traffic grew by 51 billion minutes (a 44% increase) to 167 billion in 2012. Given the magnitude of VoIP calling it is surprising that TRAI has not looked into its effect on the volume of outbound metered calls from India; and has instead apparently attributed the reduction in metered outbound calls from India to an absence of competition.

If TRAI's regulation delivers what it intends, the impact of the proposed intervention could be material

TRAI dismisses the impact of its proposed regulation: "it has been observed that the average share of revenue earned from STD call (sic) and ISD call (sic) is about 15% and 2% respectively of the total revenue earned by them. Therefore, the above submission of the access providers is not tenable."[11] However, in the next paragraph, the Authority notes that the operators make a high (Rs. 4) margin on international calls and that "this is the main reason why some of the

[9] http://www.trai.gov.in/WriteReadData/PIRReport/Documents/Indicator%20Reports%20-01082013.pdf
[10] Telegeography Report – Traffic Analysis. Primetrica Inc. 2013.
[11] Paragraph 34

integrated TSPs with a substantial share in the telecom sector are not in favour of introducing competition in the long distance sector through introduction of calling cards". Surely the TRAI cannot have it both ways? Either the proposed intervention will hurt the revenues of existing TSPs or it will not. If TRAI's intervention reduces STD and ISD prices—as the TRAI intends— then its impact on the revenues of the integrated TSPs will be material. There could be a number of effects:

- *1st order effect*: an operator reduces the prices of STD and ISD calls to avoid losing revenue to calling card providers. If international call prices are reduced by 30% and STD calls whilst roaming fall by a similar percentage, the revenue reduction for the industry would be in the order of Rs. 2,250 crores.[12]

- 2nd order effect: operators seek to rebalance prices and increase local call charges to make up for any revenue loss.

- 3rd order effect: if this is unsuccessful, revenue per site will fall and operators will roll out fewer new sites.

In the TRAI's recently released report on the Shareholding, Financing and Capital Structure of Indian Private Telecom Access Service Providers it notes:

> *Low market tariffs and the presence of large number of service providers in each licence service area have caused profitability to decline and made the telecom sector less attractive for infusion of equity*
>
> *The sector is characterized by mounting competition, declining average revenue per user (ARPU) and rising costs. All these factors put tremendous pressure on operating margins. The main reasons cited by telecom service providers for declining profitability are their inability to pass on cost inflation due to hike in the price of power & fuel, debt servicing burden and the declining value of the rupee. This has been further aggravated by the prevalent tariff competition. Service providers are pinning hopes on future improvements in profitability as data use grows in the next 5-7 years with proliferation of smart phones especially amongst the younger generation.*

It is therefore puzzling that TRAI is considering an intervention which, in its own eyes, could result in lower prices, margins and ARPUs and more operators per circle.

This type of intervention is not used by regulators in competitive mobile markets

Vodafone is unable to find examples of this kind of intervention in competitive mobile telecommunications markets. This is not surprising. This type of access regulation has previously been imposed upon incumbent fixed line monopolists to impose competition on call types—long distance and international—where the prices and margins are high; often with the expectation that this will result in a rebalancing of prices.

[12] We assume no elasticity effect.

In the above case, the access seeker does not have a 'local' network of its own and it therefore requires access to the monopolist's customers and network to be able to compete. This is unrelated to the situation in India. We have between six and nine vertically integrated operators per circle who compete for all of the customer's telecommunications needs. If a customer is unhappy with the price and quality of a service offered by its supplier, he or she can easily switch to another. As we note above, of the 30 or so NLD and ILD licensees who do not have an access network, none has approached Vodafone to negotiate a calling card access agreement.

Any regulation should simply endorse the retail minus pricing principle

Vodafone believes that there is insufficient evidence of a problem to warrant the TRAI setting the terms of trade between the parties to a calling card agreement. Nevertheless, if TSPs cannot agree commercial terms it may be helpful if TRAI were to indicate the basis on which it would specify the access arrangements. We advocate a 'retail minus' pricing principle where the charge to the calling card provider for access would be the average retail charge of the call being substituted by the new provider, less the costs that the access provider saves in routing the call to the IN gateway (i.e., those costs associated with NLD/ILD carriage).[13]

The retail minus approach ensures that there is no 'free lunch' embedded in the commercial terms. The new competitor should not be able to 'free-ride' at a preferential rate; it has to do something 'better' than the access provider in order to carry a customer's calls. If it can offer this, both parties to the agreements should benefit:

- If the access seeker is able to provide the service more efficiently i.e., if its costs beyond the point of handover are lower than Vodafone's, it will be able to pass a proportion of those savings on to the customer in the form of lower prices. In this way both the acquirer of the customer and the supplier of national / international calls will benefit. The former through higher volumes generated through lower prices, and the calling card supplier through the margin earned on the calls that it carries; alternatively,

- If the calling card provider provides a higher quality service[14] it will be able to charge a premium to the market rate and earn a margin over its costs. Vodafone would be no worse off if the call volumes are not impacted and better off if the higher quality service stimulates additional calling.

An example from the UK

We can find no *recent* examples of similar regulations being imposed upon providers of mobile services. However, a similar type of access arrangement was proposed and imposed upon Vodafone and Cellnet in the UK in 1999.[15] Oftel, the regulator, was concerned that competition was not fully effective and it sought to impose 'Indirect Access' (IA) as a way of stimulating further competition. This facility allowed mobile customers to choose how their calls are routed.

[13] For example, if the average retail cost of ILD calling is Rs. 8 per minute and Vodafone's cost of international carriage is Rs. 4 per minute, the access charge would be Rs. 4 per minute.
[14] We assume that the calling card provider is subject to the same QoS regulation as the access provider.
[15] See Customer choice: Oftel's review of indirect access for mobile networks, February 1999.

Oftel was anxious to find a form of IA which "avoids inhibiting investment". It was concerned that if the charges for access were set too low this "could damage network competition, and encourage the entry of IA operators who have no serious intension of developing new services and are unlikely to have a long term commitment to customers". At the same time if charges were set too high this "shuts the door on promising possibilities of alternative choices for customers".

Oftel opted for an IA charge which "allows for the development of choice, but is neutral in terms of its effects on the revenues of the networks on which IA operators, service providers and customers depend. This would allow IA to be made obligatory but without damaging network competition, whilst opening up opportunities for genuine new service providers who have more to offer than cut-price calls". This meant that Oftel decided that the rate for IA would "..be devised by starting from the premise that the charge for IA should not be based on adding up the direct costs of call origination but on subtracting from the retail price the cost elements that the mobile network will not incur on IA calls".

We believe that the commercial arrangements that we have concluded strike a fair balance between the requirement of Vodafone to continue to invest in its network and services and the opportunity for new providers to offer innovative and attractive services to our customers.

MTCs cannot be used as the basis for the revenue share arrangements

In the consultation the TRAI talks of determining the revenue share arrangements based on the 'work' done principle. However, it cannot simply use the mobile termination charge as a proxy for the cost of origination because the former excludes capital costs and therefore it does not capture the costs of the 'work done'. As the Hon'ble TDSAT said in the judgement quoted by the TRAI:

> *"It is not in controversy that cost would include CAPEX/OPEX and depreciation". 114(12)*
>
> *"It must not be forgotten that every operator must keep its network maintained for use by its own subscribers as well as by subscribers of another operators on equal basis. If that be so, we fail to see any reason as to why the traffic sensitive cost contained in CAPEX should be kept out of consideration" 114(12).*

The inclusion of capital costs is consistent with the Authority's regulation of Domestic Leased Circuit ceiling prices. In paragraphs 4.8.1 and 4.8.3 of its April 2005 notification TRAI explains: "[t]wo factors have to be considered when calculating the required annual return to an operator, above and beyond the opex cost that have already been discussed: recovery of depreciation on assets, and return on capital employed (ROCE), which is also known as weighted average cost of capital (WACC)…….Since cable and equipment are long-lived assets, there is a need to devise a mechanism for recovery of the capital expenditure (capex) over a period of time, besides providing for opex….annual depreciation rates of 5.28% and 11.88% have been assumed for capex recovery of cable and equipment, respectively."

TRAI says that "[a]n alternative option could be to provide some markup over and above termination charge to compensate for common costs incurred by the Access Provider." Unfortunately the TRAI does not explain these terms. In our view, any fee charged by an access provider must include a markup to compensate for common costs; these are actual economic costs which must be recovered or a competitive firm will go out of business.

Moreover, access operators' charges must cover *all* of the costs associated with call origination; these include retail billing, marketing, and customer acquisition costs (as well as the capital costs noted above). Retail costs are <u>not</u> recovered from termination [as the TRAI stated in its 2011 affidavit to the Supreme Court[16] "Sales and Marketing costs are not considered for termination charges as termination activity does not involve selling and marketing"] and therefore they *must* be recovered from origination services (or the TSP will go out of business).

Although the provision of calling card services displaces an outbound national or international by the access provider it only saves the incremental costs associated with the *subsequent carriage* of the call (the payment to the NLD/ILD operator); the access provider does not *save* any marketing, acquisition costs and retention costs. These costs, which benefit the calling card operator, are still incurred and they must be recovered across all outbound calls and therefore embedded in the charges levied for calling card access. Failure to recover these costs from the charges to other operators would effectively mean that the access provider is subsidising the 'calls business' of its competitor; the access provider would be required to recover its costs over fewer minutes resulting in higher charges for the existing customers.

Setting the price of access too low will *discourage* investment in access and *encourage* investment in NLD/ILD businesses. This would seem to at odds with the broader policy goals of Government.

Vodafone submits that any charge levied by an access provider must allow it to, at a minimum, recover capital, common and retail costs. The current MTC charge is wholly inadequate for this purpose. It neither includes capital or retail costs nor does it reflect the increase in spectrum (i.e., common costs). Estimating the costs of originating and terminating calls is a complex and lengthy exercise which proper consultation. We believe that this consultation is not the place for such and exercise and we request the TRAI to endorse the revenue-minus proposal described above.

Vodafone India Limited

December 2013

[16] IA No. 12-22 of 2011 paragraph 4.5. See also 4.14 (d).

Our answers to the specific questions raised by the TRAI:

Whether the access charges to be paid by NLDOs/ ILDOs to access provider for calling cards should be prescribed both for NLD and ILD calls or for ILD calls only?

TRAI offers no justification for prescribing NLD charges (its sole reason for intervention cites the trend of inbound and outbound international calling) and doing so would appear to contradict the stance that it took at the outcome of the national roaming consultation. There would appear to be no valid reason to prescribe the charges for NLD calls. Indeed, the revenue per minute for an STD call (Rs. 0.56p – see paragraph 36) would indicate that these calls are priced very competitively relative to cost. Any intervention, although unwelcome, should be confined to ILD calls.

As the work done by the Access Provider is the same for NLD and ILD calls, should the originating access charges for NLD and ILD calls be the same or different?

What method should be applied for prescribing originating access charge to the Access Provider? Please provide all details including data and calculation sheets, if any.

We advocate a retail-minus approach to setting access charges for international calls (we do not believe that TRAI should set NLD charges—see above). If instead charges are set on the basis of work done, these rates should include capital costs, retail costs and a contribution to common costs.

Whether the access charges should be same for mobile and fixed line?

No, charges should be set on the basis of retail-minus.

What are the issues that need to be addressed to ensure calling cards are also used when a subscriber is roaming?

As we say above, TRAI should not regulate the price of access to calling card services for NLD services. TRAI has recently considered the market for national roaming and mandated the introduction of two plans (RTP and RTP-FR), together with permitting the introduction of Special Tariff Vouchers. These changes have been positively received by customers; Vodafone's own RTP-FR plan allows customers to reduce the cost of STD calls when roaming by 40%.

What are the prevalent regulatory practices in other countries regarding access charges in case of calling cards?

We can find no current example of this type of mandated access to mobile operators. As noted above, Oftel considered the matter in 1999 and adopted a retail-minus approach to the access charges.

Any other relevant information related to subject along with all necessary details.

Please see above.