Cellular Operators Association of India

WITHOUT PREJUDICE

TVR/COAI/026
February 11, 2009

The Telecom Regulatory Authority of India
Mahanagar Doorsanchar Bhawan
Jawahar Lal Nehru Marg (Old Minto Road)
Next to Zakir Hussain College
New Delhi 110002

Re: Review of the IUC Regime; TRAI Letter No. 409-12/2008-FN

Dear Sir,

This is with reference to your above mentioned Letter No. 409-12/2008-FN dated 23rd January, 2009.

As you are aware, COAI vide letter No.TVR/COAI/009, had requested the Authority to share with the industry the assumptions, cost elements and methodology used by them to arrive at the termination charges stated in the TRAI Consultation Paper. This Information is sought so that COAI and its member companies could clearly understand the exact details of the cost elements used, the value assigned to each element etc, so that the industry can more effectively participate in the ongoing IUC review.

It would be appreciated that **a clear and transparent understanding of the issue would not only help us engage more productively in the ongoing review exercise, but will also enable the development of an industry consensus in the matter.**

It is however respectfully submitted that the details shared by the Authority vide its Letter No. 409-12/2008-FN in determination of termination charges are not adequate for us to understand the assumptions and methodology used by the Authority to arrive at the MTC and/or compare the same with the results of the Hybrid FLRIC model which is based on international best practices, that has been proposed by COAI. .

In this regard, we would like to submit the following:

I. Para. 4 (a) and 4(b) of the Authority's letter states that :

"It has been said in Para 5.3.1.3 that fully allocated cost method has been earlier used and the stakeholders have been asked to give their comments on continuation of this approach or otherwise.

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In Para 5.3.1.4 it has been said that TRAI has carried out an analysis of the termination charges using methodology that it has used earlier using the cost data submitted by various service providers."

1. In this regard, it is most respectfully submitted that:

   - Since we are not aware of the details of the 2003 IUC exercise, we are also not able to appreciate what factors have changed in 2007-08. In fact, we have consistently been seeking clarity on the calculation methodology since 2003 but the same has never been shared with us. Thus, a simple statement that the methodology followed earlier has again been adopted and that the same is based on the fully allocated cost (FAC) method, does not help us to understand the calculation methodology followed by the Authority.

   - It is also not clear, whether the FAC model used by the Authority, is based on historical costs or current costs and which operators' cost information has been relied for the said model, whether an average approach or an incremental approach has been applied, what the method of depreciation, etc. Hence, it is respectfully submitted that the information provided is insufficient and does not at all clarify the methodology, assumptions, network design and workings used by the Authority to arrive at the termination charge.

2. We believe that **all would benefit from a frank and transparent discussion on the calculation methodology, which may be shared with us in a spread sheet (Excel) format so that we are able to clearly understand the cost elements, the assumptions and linkages that have been used by the Authority to calculate the MTC.**

3. We would therefore like to once again respectfully urge the Authority to kindly provide the operator wise data/methodology/calculation/approach, etc. as per the format suggested above, that has been used by the Authority to arrive on these termination charges (Rs. 0.13 to Rs. 0.30 per minute)..

4. It is further submitted that **the Hybrid FLRIC model, based on a hypothetical efficient operator is widely accepted to be the international best practice** for determination of termination charge as it provides a view on likely costs of the network going forward, verified against actual past performance and gives the lowest MTC.

5. The Long Run Incremental Cost Model (LRIC) has emerged as the preferred choice of regulators not only in Europe but also in several developing markets and there is a clear shift towards the use of FLLRIC model.

6. We have already placed before you the international best practices in cost modelling for determination of MTC and the same has also been detailed in the White Paper by Spectrum Value Partners (SVP) and the GSMA Report on "The setting of mobile termination rates : Best practice in cost modeling" submitted by COAI to the Authority vide letter No. TVR/COAI/219 dated October 23, 2008.

7. **The fact that the calculation methodology should be based on the FLLRIC model has also been recognized by the Authority** in its notification (No. 409-5/2003/FN, dated 29th October 2003), wherein TRAI has stated that there is a need to eventually move to LRIC based MTC estimation model. An extract from TRAI's notification of 2003 is given below:

   "The Authority considered the framework used for calculating the IUC under the previous exercise, and noted that the cost basis used had been historical average costs from audited accounts of BSNL. It noted that ***for costing purposes, several countries had used Forward Looking Long Run Incremental Costs (FLLRIC)****, i.e. a methodology under which only a portion of stranded costs (or costs arising due to past high equipment prices or old technologies) is included in the calculation of costs."*

   "The Authority noted that the difference between historical costs and forward looking costs would be large, and relying on costs based only on modern and forward looking technologies would imply a large burden from the stranded costs for BSNL. While ***the Authority feels that change over to FLLRIC model is imperative****, it examined the implications of a sudden changeover against a gradual changeover. Since BSNL is the major supplier of telecom services in the country and has also contributed the maximum for achieving the targets of rural teledensity and in supporting low paying subscribers, a changeover to FLLRIC at present would adversely affect the services provided not only to rural and low paying subscribers but also the telecom industry in the country as a whole. The Authority noted that BSNL is already deploying latest technology and lower cost equipment in its expansion programme. Since wireless technology is being used, it is expected that some of the existing network will also be gradually replaced by such equipment.* ***In short, the approach is to achieve full shift to FLLRIC cost in a gradual manner over a few years rather than a single year change."***

8. It is evident from the above that the **Authority too, has recognized that the FLLRIC is used by several countries and that a changeover to the same is imperative, but that this should be done in a gradual manner.** It is most respectfully submitted that **over five years have elapsed since the above views were enunciated by the Authority and there is no indication of any shift, gradual or otherwise, that is being contemplated by the Authority.**

9. Under these circumstances, we believe that the **Authority may like to clarify why it would like to continue with the FAC model in the light of the overwhelming international evidence and also its own views that Hybrid FLLRIC is a better approach.**

II. <u>Para. 4 (c) of the Authority letter states that</u> :

Determination of Termination Charges is based on the methodology that the relevant operational expenses are recovered from air time/call charges and capital expenditure from the rentals. Therefore for calculating MTC, TRAI has taken relevant OPEX for telephony services (Excluding the components, which are not relevant for providing the telephony services i.e. marketing expenses, bad debts etc.). The similar methodology was also used to estimate termination charges on the fixed wireline networks.

1. We would first like to submit that, **it is not clear as to what, as per the Authority comes under the category of *"relevant"* operational expenses**. Whilst the Authority has given a few illustrative categories, it is submitted that **in order to have complete clarity on the cost model, it would be necessary to know all the cost items that have been taken in to consideration for the determination of MTC as also all the cost items excluded, along with a justification for each inclusion/exclusion.**

2. The Authority has not shared with us the cost elements which have been used. We therefore once again request the Authority to kindly share the full details regarding each and every opex and the capex cost elements included/excluded in determination of termination charge.

3. The information provided by the Authority's letter does not give the details of the capex and opex elements used and hence makes it impossible for us to understand the Authority's approach in determination of MTC.

4. We also note that the **Authority had indicated/conveyed that it was following the approach of recovering "relevant" opex from call charges/airtime and capex from rentals**. In this regard it is first submitted that **such an approach is not in line with the international best practices** adopted by regulators in other parts of the world. Furthermore, we believe that **such an approach is also deeply flawed in the context of the Indian market where more than 90% of the subscribers are prepaid and there is no concept of "rentals" from which capex can be recovered**. In such a scenario, it is amply clear that the methodology adopted by the Authority will not result in the correct determination of cost based termination charges.

III. <u>Para. 4 (e) of the Authority letter states that :</u>

Para 5.3.1.10 of the consultations paper it has been said that employing the same costing methodology as used in its prevailing costing exercise of IUC (i.e. 29th October, 2003) for determination of Mobile Termination charge revised estimates of MTC have been arrived at with the data of the financial year 2007-08 for mobile service providers . In this costing exercise with same operating cost items, as taken in previous exercise, without deducting the VAS revenues from relevant OPEX, the range of MTC comes Rs 0.13 to Rs 0.30 per minute.

1. You would appreciate that COAI has participated in the ongoing review of IUC regime and has made several submissions to the Authority. As stated above, we had

submitted that the Hybrid FLRIC approach is the international best practice and results in the lowest MTC. **This view has also been taken by the Authority in 2003, wherein it had opined that "*change over to FLLRIC model is imperative.*"**

2. It is also **generally accepted that a FAC model leads to higher costs as it builds in to the model, the costs and inefficiencies of an operator**. Under these circumstances, it is inexplicable as to how the Authority can continue to advocate and adopt the FAC approach. We are also **at a loss to understand how the Authority, using the FAC approach, has arrived at the lower MTC in the range of Rs 0.13 to Rs 0.30 per minute,** whereas COAI, using the Hybrid FLRIC Model, has arrived at an MTC of Rs 0.30 to Rs 0.38 per minute for the year 2008 to year 2012.

3. We therefore **seek the indulgence of the Authority to kindly explain to us as to how the FAC approach used by the Authority has resulted in a lower MTC as compared to the FLLRIC approach used by COAI.**

IV. Para. 4 (g) of the Authority letter states that :

Main assumption regarding revenue of value added services is already mentioned in the consultation paper and the estimated revenue of value added services is considered about: 10 % of total' revenue.

1. With regard to the above, we would like to submit that **there is no clarity on the network and cost elements** which have been **considered with regard to provision of VAS services.**

V. Para. 4 (h) of the Authority letter states that :

The suggested calculations are based on top down model taking into account the actual data provided by service providers in their accounting separation reports and, therefore, the network design, calibration and cost of individual network elements, which are relevant for bottom up approach suggested by TRAI in their pre-consultation response, are not relevant.

1. In this context our submission to Para 4(a) and 4(b) of the Authority letter are reiterated.

2. We are also **not clear as to how the top down approach has been applied by the Authority without taking into account network design and cost of individual network elements.**

3. Further, as submitted earlier, **it is our belief that the Hybrid FLLRIC model proposed by COAI,** wherein the results of a bottom up model are reconciled against top-down data, builds in efficiencies into the model and thus **gives more accurate cost based results rather than relying on just the top down approach**.

In light of our above submissions, **we would thus like to once again earnestly urge the Authority to share with us in a transparent manner its assumptions, methodology, working/calculations in the format suggested above** so that we are able to understand the approach followed by the Authority in the determination of termination charges.

As submitted, **this information will facilitate a constructive dialogue and a meaningful participation in the ongoing IUC review exercise.**

Kind Regards

Sincerely yours,

T.V. Ramachandran
Director General

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