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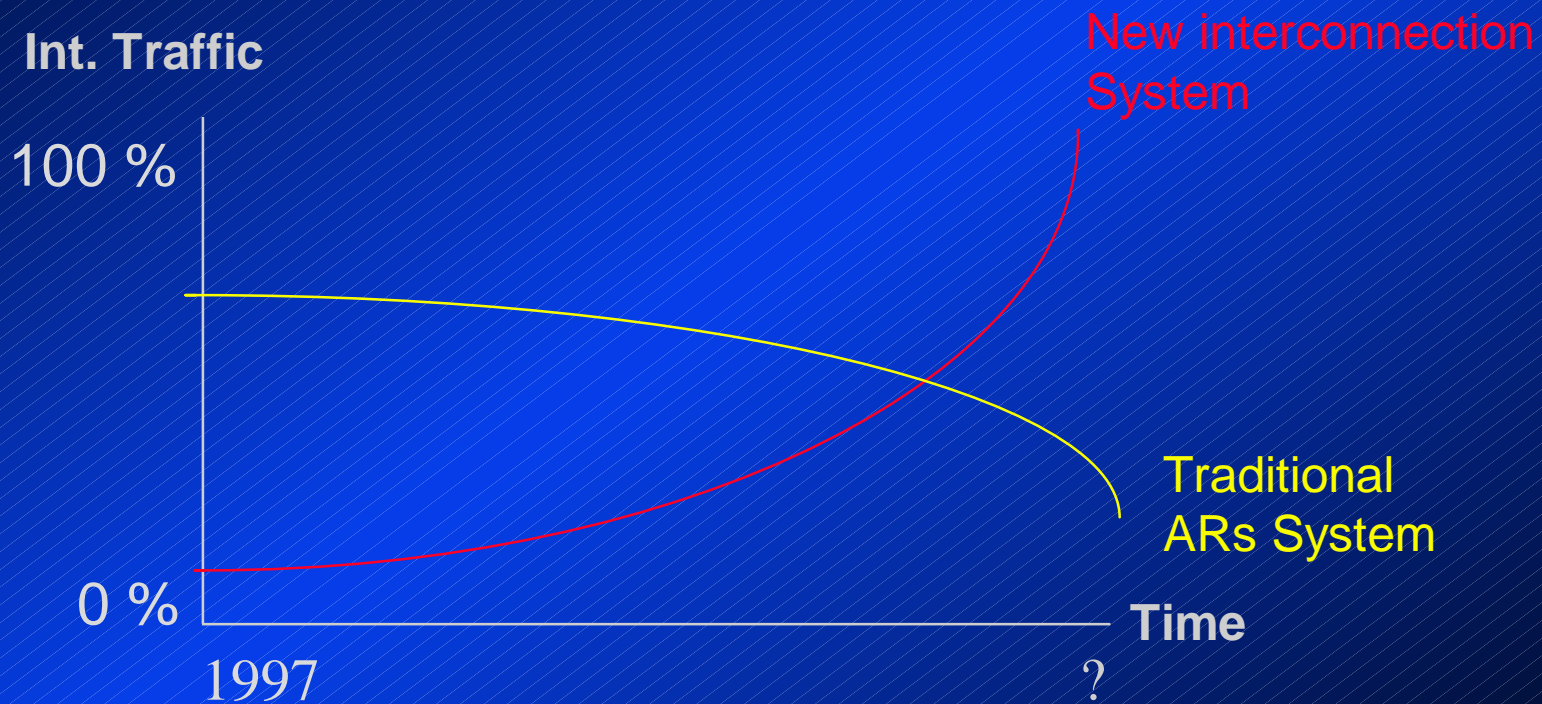
**CROSS-BORDER INTERCONNECTION
AND ACCOUNTING RATES:**

**A COMPETITION LAW AND
NEWCOMERS' PERSPECTIVE**

BY:

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HANDLING OF "INTERNATIONAL" TRAFFIC WITHIN THE EU:



A. The AR-System has been challenged by:

arbitrage
instruments

- Refile (use of 3rd party's lower AR)
- ISR
- LBO (= interconnect at local collection rate)
- Call-back
- Self-correspondency (= local interconnect at both ends by one entity; assumes, facilities based, liberalisation)
- Combinations thereof

B. The AR-System has been defended by:

- **Parallel accounting**
- **Proportionate return (return traffic income)**
- **Minimum volume for foreign newcomers (no AR unless e.g. at least 5% of the international traffic to a certain country/monopolist operator)**

The biggest threat to the traditional AR-system within the EU seems now Interconnection.

Is the traditional AR-system defenseless?

SOME CHARACTERISTICS OF THE TWO SYSTEMS

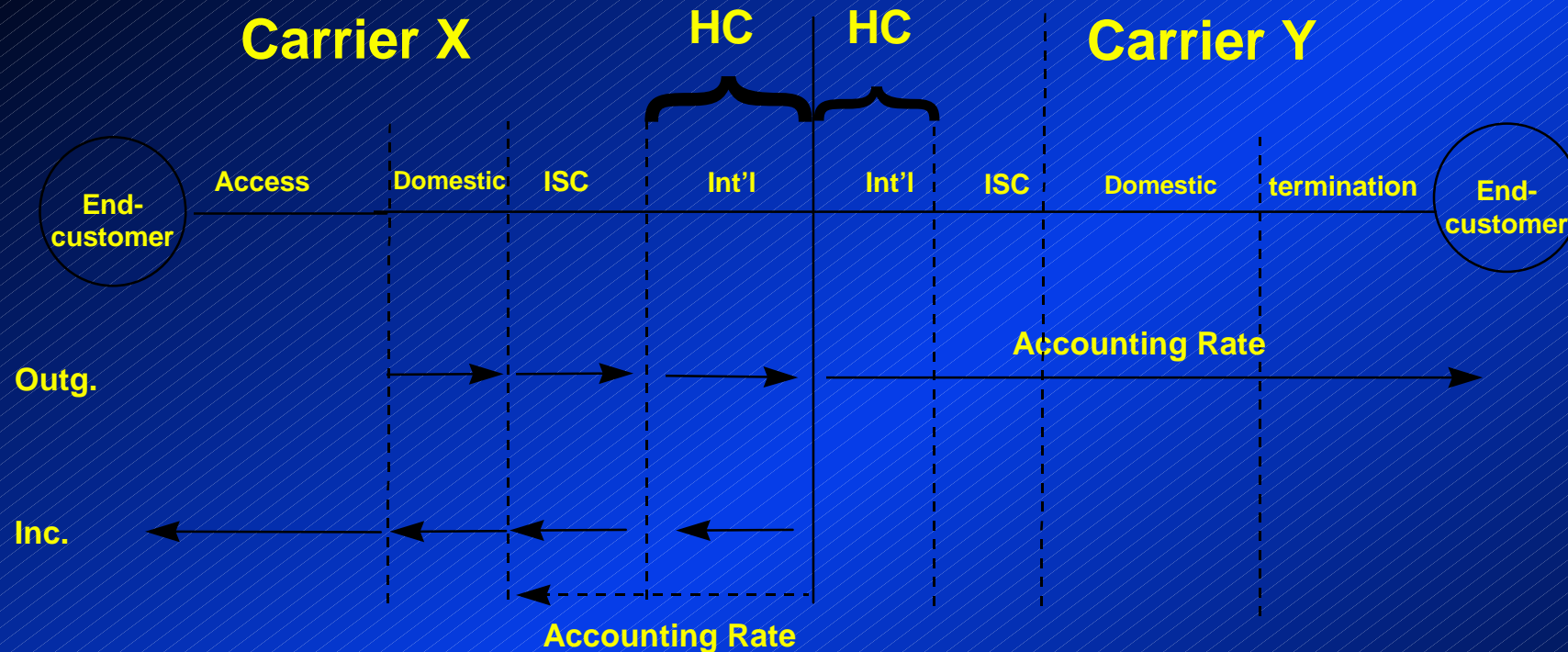
OLD (AR) SYSTEM

- Monopolist, non-competitive (one player per area; non-liberalized)
- Inherently bilateral/mutual traffic handling
- No normal commercial conditions
 - a. one service (limited service differentiation)
 - b. no quality guarantees
 - c. volume/scale independent
 - d. low-cost network irrelevant
- No effective competition law (art. 86) application
- Price differentiation depending on origin of traffic
- No price differentiation depending on final destination within a country
- Worldwide

NEW (INTERCONNECT) SYSTEM

- Competitive, multiple players within the same area (liberalized; enabling make or buy decisions)
- Also unilateral (traffic flow)
- Normal commercial conditions:
 - a. Multiple services
 - b. Quality guarantees
 - c. volume/scale critical
 - d. flexibility and low cost network essential
- Effective competition law (art. 86/interconnection directive application)
- Price differentiation unrelated to origin of traffic, but depending on defined POI.
- Price differentiation depending on final destination within a carrier 's network (local, regional, long-distance)
- Limited to liberalized countries

A. Cost-Elements of "AR-service"



Cost Outgoing Minutes = $(AR + Int'l + Domestic + ISC) \times Volume$

Revenue Incoming Minutes = $(AR - Int'l - Domestic - ISC - Termination) \times Volume$

— = cost

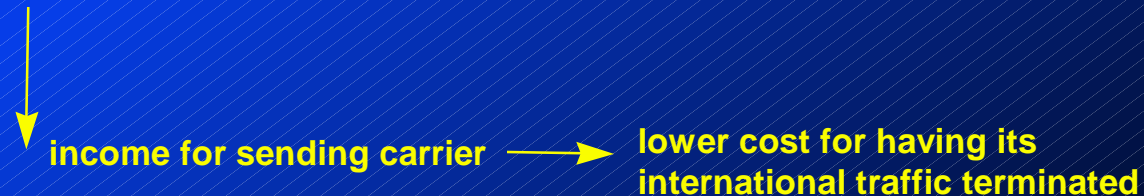
- - - = revenue

HC = half-circuit (at operator level)

B. Cost-Elements of the “AR-Service”

In short, the AR-service for termination consists of:

- a transmission part (half circuit offered by terminating carrier)
- a switching element (ISC)
- a termination part (from ISC to end-customer)
- (TAR: return traffic)



Situation as of 1/1/1998 for the AR-Service in the EU

- At least as of 1/1/1998, the AR-service within the EU is nothing else than a mutual international/cross-border interconnect service
- and will thus be subject to art. 86 and the Interconnect Directive
- and therefore should be (in case of significant market power):
 - cost based
 - transparent & published (!)
 - sufficiently unbundled (—————> mutual deal unbundled into unilateral “AR”)
 - applied non-discriminatory to incumbents and newcomers

Significant market power - a need for differentiation

The AR-Service seen from an art. 86-perspective

- A. Terminating traffic: as (at least) local loop will likely remain a bottleneck facility, art. 86/interconnection directive fully applicable (relevant market being the local (regional/national) market for termination).
- When “AR” > interconnection (depending on POI), interconnection will be used.
 - When “AR” < interconnection (depending on POI), same (unilateral unbundled “AR” for terminating traffic will be asked for.

Significant market power - a need for differentiation

The AR-Service seen from an art. 86-perspective

The mechanics for the use of the AR or Interconnect service for termination

Example:

- Foreign incumbent has a TAR of 2 units with terminating incumbent (= settlement rate of 1)
- Terminating incumbent has interconnect rate for long distance of 1 and for local of 0,5

Result: for long distance (international) calls same (unilateral/unbundled "AR" for termination will be asked for; for local calls (from POI) interconnect will be sought.

Significant market power - a need for differentiation

The AR-Service seen from an art. 86-perspective

- NB1:** In case of too large (non-cost based) difference between long-distance and local interconnect, newcomers will set up multiple points of presence (with as much as local POIs as possible; decision to make instead of buy; alternative: foreign newcomer to use of service of local newcomer (e.g. a mobile operator) which resells its local interconnect deal).
- NB2:** What will be the role of mutual international traffic handling? On the one hand, mutual cross-border interconnection (= AR) is a bundled service; on the other hand mutual cross border interconnect does have lower cost than unilateral cross-border interconnect.

Significant market power - a need for differentiation

The AR-Service seen from an art. 86-perspective

B. Originating traffic:

Does an incumbent have significant market power for the international handling of international traffic originating in the same country? For example, should such incumbent publish and apply non-discriminatory all of its ARs / settlement rates (unbundled or not) it has with any other operator in the world?

As such it is part of a service offered to any subscriber of the incumbent. Why not have it unbundled at wholesale level (= offering interconnect to handle international outgoing traffic)?

Significant market power - a need for differentiation

The AR-Service seen from an art. 86-perspective

C. Transit traffic:

Does an incumbent have significant market power for the handling of international traffic originating abroad and to be terminated abroad? Arguably not, as customers for such hubbing service can go to other incumbents which use their ARs for this service or newcomers who have an interconnect with the terminating carrier. The relevant market seems EU-wide, if not global, for such a transit service.

CONCLUSION:

“Crossborder” interconnection does not necessarily mean the end of the AR-system, even between liberalized countries. Assuming effective competition, it does mean for terminating traffic the end of non-cost based accounting rates, as alternatives (e.g. interconnect) will force ARs to a level of cost plus reasonable margin. Such competitive AR could be the start of a “new age” “AR” system (as mutual deals have cost advantages over unilateral deals; and with similar volumes you might as well as settle; see e.g. Internet peering).

If this situation comes true, the origin of traffic should be irrelevant and the final destination of traffic should determine the AR-level. In such a case the price of an AR is the same as the price for mutual interconnect for international traffic between similar operators (= “new age ARs”).