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CROSS-BORDER INTERCONNECTION AND ACCOUNTING RATES:

A COMPETITION LAW AND NEWCOMERS' PERSPECTIVE

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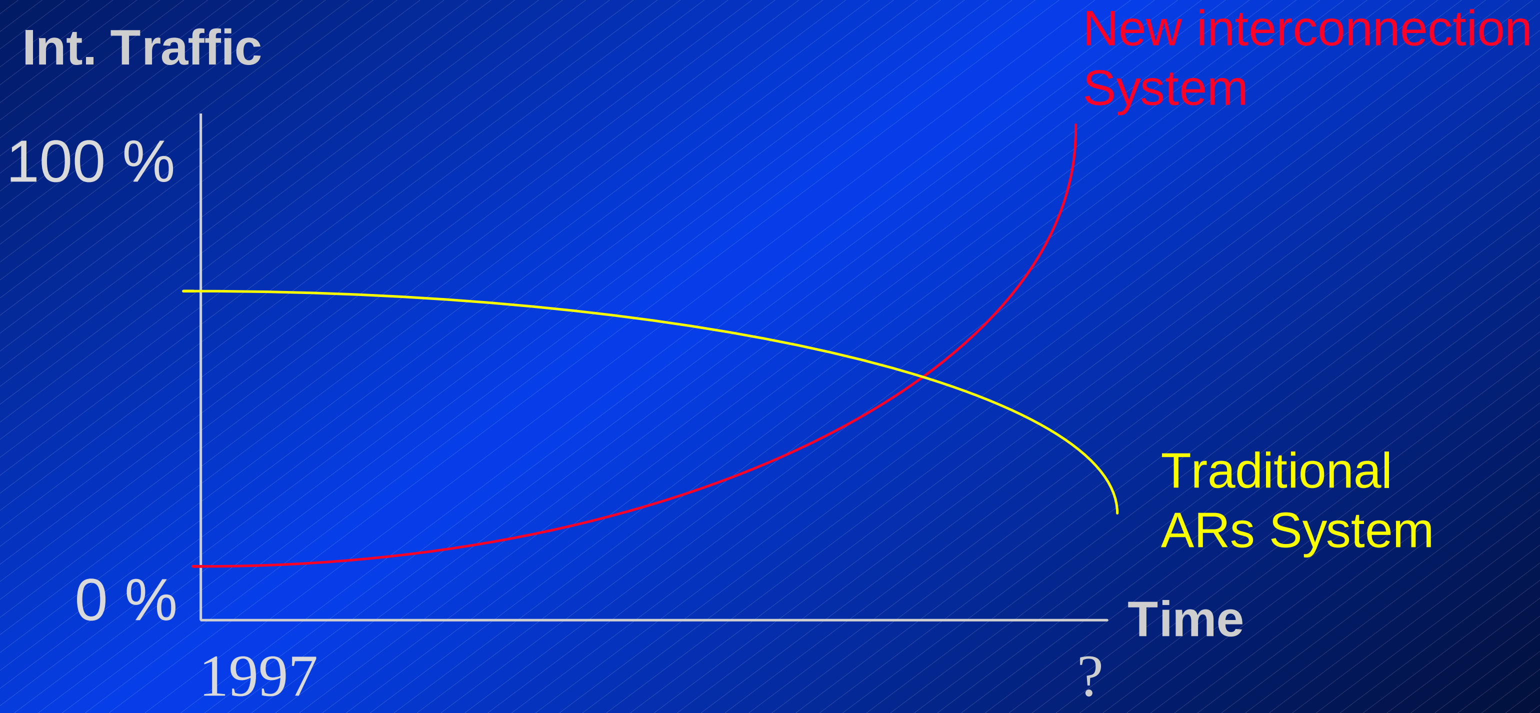
HANDLING OF "INTERNATIONAL" TRAFFIC WITHIN THE EU:



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 inter-connect 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)

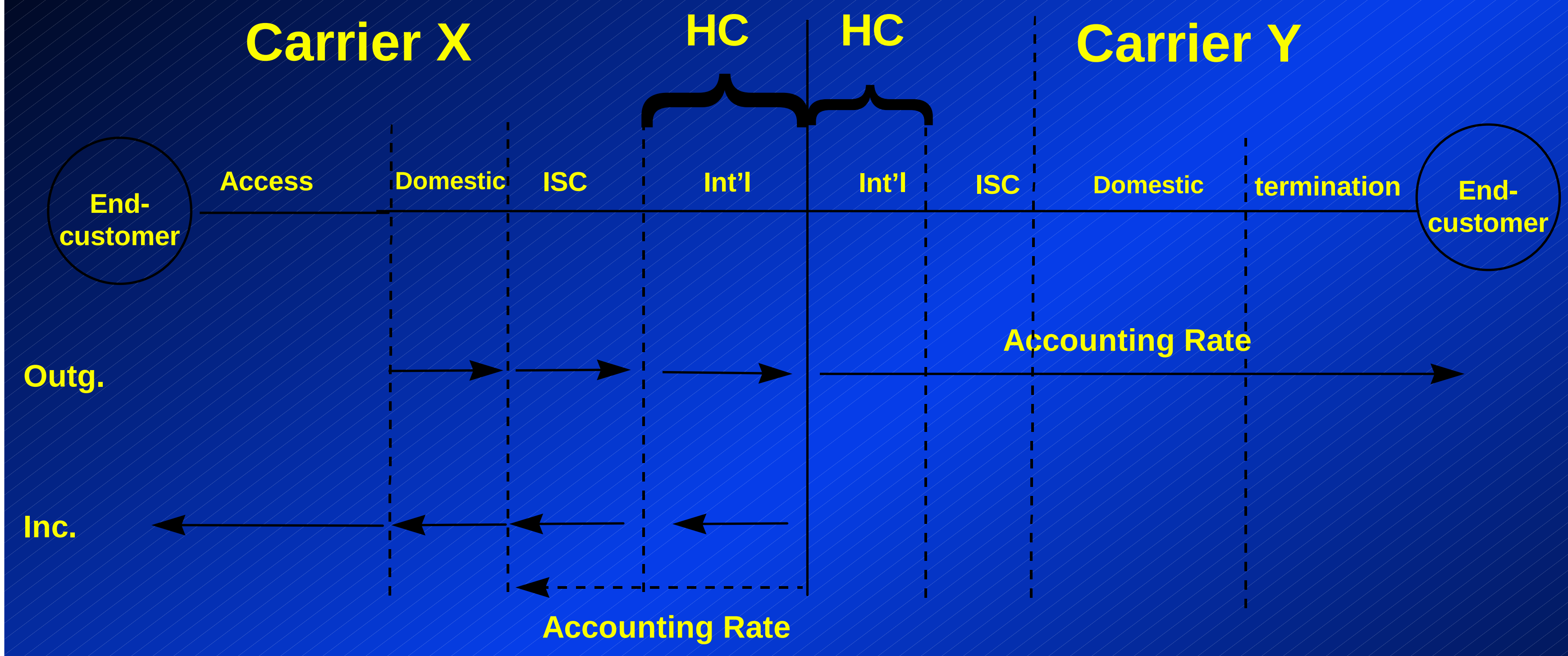
The biggest threat to the traditional AR-system within the EU seems now Interconnection.

Is the traditional AR-system defenseless?

SOME CHARACTERISTICS OF THE TWO SYSTEMS

OLD (AR) SYSTEM	NEW (INTERCONNECT) SYSTEM
• Monopolist, non-competitive (one player per area; non-liberalized)	• Competitive, multiple players within the same area (liberalized; enabling make or buy decisions)
• Inherently bilateral/mutual traffic handling	• Also unilateral (traffic flow)
• No normal commercial conditions	• Normal commercial conditions:
a. one service (limited service differentiation)	a. Multiple services
b. no quality guarantees	b. Quality guarantees
c. volume/scale independent	c. volume/scale critical
d. low-cost network irrelevant	d. flexibility and low cost network essential
• No effective competition law (art. 86) application	• Effective competition law (art. 86/interconnection directive application)
• Price differentiation depending on origin of traffic	• Price differentiation unrelated to origin of traffic, but depending on defined POI.
• No price differentiation depending on final destination within a country	• Price differentiation depending on final destination within a carrier 's network (local, regional, long-distance)
• Worldwide	• Limited to liberalized countries

A. Cost-Elements of “AR-service”



Cost Outgoing Minutes = (AR + Int’l + Domestic + ISC) x Volume

Revenue Incoming Minutes = (AR - Int’l - Domestic - ISC - Termination) x 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)

income for sending carrier → lower cost for having its international traffic terminated

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 un-bundled into unilateral "AR")
  - applied non-discriminatory to incumbents and new-comers

Significant market power - a need for differentiation

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

A. <u>Terminating traffic</u>: 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 custo-mers for such hubbing service can go to other incum-bents 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").