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Telecommunication Newsletter Switzerland

The Future of Cost Oriented Access: The Draft of the New Telecommunication Ordinance

1. Introduction

According to Art. 11 para. 1 Telecommunication Act ("TCA") dominant carriers are under an obligation to grant competitors non-discriminatory and transparent access to their network at cost oriented prices. The primary goal of the sector specific regulation is to foster efficient competition in the market in the interest of the consumer. The legal framework for the determination of transparent, non-discriminatory and cost oriented access has been further detailed in the Telecommunication Ordinance ("TCO") and its application clarified by the various decisions rendered by the ComCom and the Federal Administrative Court in the access proceedings over the past years.

The immediate need for a revision of the TCO is seen in the technological change from the legacy network to the NGN which already started years ago. The Federal Council is therefore of the view that the current framework on access costs must be adjusted.[1] The application of the existing framework was the subject of strong criticism in several access proceedings brought by alternative providers; however the Federal Administrative Court - whilst acknowledging the flaws of the existing regulations - held that it is not within its power to interfere, where action must be taken by the legislative.

The draft ordinance does not completely throw the existing framework over board, but provides for correctives for the calculation of cost oriented prices in particular in relation to the last mile, cable ducts and provides clarification in respect of the non-discrimination obligation. It is largely based upon the WIK report of May 2012 commissioned by the Federal Communication Office ("OFCOM").

[1] See: Draft Explanatory Report of the Federal Department for Environment, Traffic, Energy and Communication dated 17 April 2013 (Explanatory Report).

2. New reference network is an IP based fibre network

The price model of the TCO is based upon the theory of contestable markets. Consequently not the actual costs but the hypothetical costs of an efficient provider building its network with the latest technology (Modern Equivalent Assets). These costs of the Modern Equivalent Assets ("MEA") are then used as the basis for the calculation of cost oriented prices under the prevailing legal system. In the past, however, the costs for the access to the last mile were calculated on the basis of a copper network and on the basis of a switched carrier network. Currently, however, the access network is constantly being replaced by fibre and transitioned to an all IP based network.

Under the draft ordinance the legacy network and legacy technology will no longer be relevant for the calculation of access costs. Instead an IP based fibre access network will be the benchmark.

3. Change in calculation method for cable ducts

The calculation methodology for cable ducts used in the past also lead to exaggerated prices as the calculation based on the costs to build the ducts and trenches, which have long been amortised by the incumbent operator. The revised costs for cable ducts should be calculated according to the costs for maintenance and renewal (Infrastructure Renewal Accounting). It is expected that this revised calculation cost will lead to a decrease of the costs charged in the past.

4. Details of the proposed changes to the TCO
4.1 Art. 1: Definition of Access Costs

Access Costs are being defined in Article 1 of the draft ordinance as the consideration demanded by the incumbent operator for the access to the incumbent operator's infrastructure and Services according to Art. 11 para 1 TCA. In substance, the introduction of this new definition has no material impact on the previous practice.

4.2 Art. 52 Non-discrimination obligation and margin squeeze

Art. 11 para 1 TCA requires the incumbent operator to permit non-discriminatory access. Primarily the non-discrimination obligation is seen as an equal treatment obligation pursuant to which an alternative provider must be treated equal to all other entities, divisions (including the incumbent operator's wholesale division), subsidiaries or partners of the incumbent operator. Art. 52 para 2 of the draft TCO clarifies this understanding.

Art. 52 para. 2 bis addresses the issue of margin squeeze and determines that the difference between the incumbent operators wholesale and retail prices must permit an efficient alternative provider to generate revenue covering at least its costs. This solution does not interfere with the incumbent operator's retail price strategy but could lead to a reduction of the wholesale costs, in case no cost covering revenue can be achieved by the alternative providers.

4.3 Article 54: Cost oriented pricing

The general principle of cost orientation modelled upon a hypothetical efficient provider remains unchanged. However, in respect of cable ducts the actual costs and investments of the incumbent operator will become relevant (see Art. 54a, supplemented by the margin squeeze control mechanism).

4.4 Art. 54a: Pricing of cable ducts

The draft ordinance addresses some of the concerns raised in the past by the alternative providers. According to the draft, the actual relevant costs of the incumbent operator for the maintenance of the existing infrastructure are being considered and not the costs that a new market entrant would have to invest to build such infrastructure. It is a general consensus that a duplication of such infrastructure is not desired.

The costs for depreciation will be calculated upon the average annual costs of the investments in the cable duct infrastructure. The costs for the capital could be calculated upon the synthetic book value of the relevant infrastructure or the replacement value of the incumbent operator.

4.5 Art. 54b Minimum Price

Art. 54b draft TCO introduces the concept of a minimum price to protect the incumbent operators, as the MEA approach to determine the cost oriented prices will no longer be based upon the actual copper pair. The Short Run Incremental Costs plus (SRIC+) of the copper net will determine the minimum price. This will permit would permit the incumbent operator to determine the costs on SRIC+ in case the MEA approach would result in prices which are lower than its short term incremental costs. This minimum price SRIC+ is not limited legacy technology.

4.6 Art. 54 c: Margin squeeze

In the case of a margin squeeze the incumbent operator has the possibility to increase its retail prices or alternatively the access price will be determined on the basis of retail minus, permitting an equally efficient alternative operator to achieve at least cost covering revenue.

4.7 Article 55: Interfaces

In view of the technology change it must be assured that the incumbent operator continues to offer TDM-interfaces also in a next generation netword (NGN) environment. A list of recommended interfaces will be published by the OFCOM.

4.8 Art. 58: Fully unbundled access

4.8.1 Fibre as the MEA for copper

Contrary to other jurisdictions, the fully unbundled access to the last mile is limited to the copper pair in Switzerland (Art. 11 para 1 lit a TCA). The MEA approach however would indicate that a new market entrant would not invest in a copper access network but would invest in a new technology. Consequently for the determination of regulated prices, Fibre to the home (FTTH) currently constitutes the basis for determining the prices for the copper product.

4.8.2 Performance delta copper fibre

Fibre as the MEA to the copper access has many advantages and can provide more and better services than the copper pair. Consequently the prices determined based on the FTTH must be adjusted (reduced) accordingly by such performance difference.

4.9 Art. 61; Interconnection

4.9.1 MEA: Change to packet switched technology

The traditional circuit switched technology is being replaced by packed switched technology (NGN). Consequently a new entrant would invest in a NGN and the costs for interconnection will have to be determined based upon the new technology.

4.9.2 Capacity based charges

The draft paragraph 3 requires the incumbent operator to also offer capacity based charges (CBC). CBC is seen as a better reflection of relevant costs, since the actual costs largely depend upon the capacity used, rather than additional minutes. Moreover CBC permits a flexible and innovative retail pricing such as flat-rate offers.

4.9.3 Glide path

It is expected that the changes proposed to be introduced by the new ordinance will lead to a further decrease of the access costs including interconnection and leased lines. The glide path introduced in the draft ordinance, hence aims at softening the consequences of a sudden decrease in revenue due to the system and technology change by allocating the full cost reduction over a period of two years.

4.10 Art.62: Glide path for leased lines

The draft also seeks to introduce a glide path for leased lines (see section 4.9.3 above).

5. Comments

The draft ordinance establishes a clear legal basis for the calculation of the access costs based upon the MEA.

Whether or not a glide path is necessary for the access costs at this point in time is disputed. It is argued that the incumbent operator, despite having largely switched the technology over the past years to a NGN has already excessively profited from legacy network cost calculations.

The changes proposed to be introduced by the ordinance are largely welcome in the industry. However, given the fast pace of the technological development in the field of communications, it is difficult to understand, why the access to the last mile remains limited to the legacy copper pair. A technology that will soon become extinct, at least in the metropolitan areas.

Although the introduction of a technology neutral access regime to the last mile would require a change of the TCA itself which will take several years, we fail to understand why the Federal Council, in addition to the draft ordinance has not also proposed to amend the TCA by the introduction of a technology neutral access and by the introduction of an *ex officio* price determination.

The latter would be in the interest of the end-users, in particular for mobile telephony. The reason why so far no carrier followed through with a request for the determination of cost oriented charges for mobile termination is the fact that to date all carriers (mobile and fix net) profit from the high termination rates which are passed on to their respective customers.

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