



**T-Mobile
comments on the
ERG consultation paper on**

“Proposed changes to the Commission Recommendation on Accounting Separation and Cost Accounting”

Executive summary

T-Mobile welcomes the possibility to comment on the ERG draft opinion for a Commission Recommendation on cost accounting and accounting separation. T-Mobile would like to encourage a subsequent consultation with market participants on a draft Recommendation by the European Commission as the EU institution is responsible for adopting the amended Recommendation. Nevertheless, T-Mobile is very concerned about the ERG intention to impose accounting separation together with other cost accounting rules on mobile carriers.

- ❑ **The introduction of accounting separation would be an inappropriate instrument for mobile markets and would lead to overregulation.** The primordial object of accounting separation were fixed network incumbents at the time of market opening – not mobile operators on a competitive market. The objective was to distinguish the incumbent's bottleneck wholesale services from retail products in terms of revenues and costs. The accounting separation framework does neither match the structure of mobile operators business nor do its major goals apply to the mobile sector.
- ❑ **The introduction of accounting separation is a severe remedy which may only be imposed after the conduct of a market analysis and the designation of SMP.** Accounting separation is not a light handed approach for data gathering but induces high burdens on the operators concerned.
- ❑ **The ERG should follow the procedures of the New Regulatory Framework and especially take into account that regulatory decisions must be proportionate, reasoned and based on the nature of the problem identified.** The focus should be on light handed less burdensome and proportionate regulatory remedies to address market failures – if these are identified at all. Unfortunately, little effort has been put into finding light handed ways to address specific mobile market needs.
- ❑ **The introduction of accounting separation for mobile operators would impose considerable costs.** Mobile operators could not easily compensate for these costs since it is questionable whether it could be recovered in the competitive retail market. Therefore, these costs would directly impact on EBITDA and would induce a deterioration of global competitiveness. Based on international experiences made in implementing accounting separation T-Mobile estimates that at least a 2 digit Mio € amount has to be invested for each operator subject to this obligation.
- ❑ **The cost of the introduction of accounting separation for the operators and the NRAs would exceed the benefits and would contradict the recent EU action plan on regulatory reform and reduction of administrative burden.** The framework covers all activities of mobile operators while only a small part of the business is subject to regulatory intervention. More proportionate remedies would include the transparency obligation (Art. 9 Access Directive) and the Non-discrimination obligation (Art. 10 AD).

- ❑ **The introduction of Accounting Separation and specific cost accounting rules for mobile operators would be disproportionate and an inappropriate limitation of their economic autonomy.** National Regulatory Authorities have a multitude of less interfering remedies. National Regulatory Authorities should consider alternative remedies where possible and choose the least burdensome effective remedy. There is no apparent reason why NRAs should make use of such a heavy-handed instrument.
- ❑ **Accounting separation is not an appropriate tool for the regulation of new industries** such as the mobile telecommunications markets which are characterized by the emergence of new technologies and extremely complex cost structures.
- ❑ **The consultation document bundles several cost accounting methodologies to the accounting separation framework.** Even if one would accept that accounting separation is a proportionate remedy the question remains why this framework should in any case be unnecessarily be combined with specific cost accounting techniques and methodologies. In terms of foreseen remedies in the Access Directive the consultation paper at least bundles the separate obligations foreseen in Art. 9, Art. 10, Art. 11 and Art. 13. This strongly reflects the ONP approach which should be abolished by the new framework.
- ❑ Instead of proposing a comprehensive one-fits-all framework which automatically includes transparency, non-discrimination, cost accounting, accounting separation and price control obligations **the ERG should follow an approach of remedy separation and carefully analyse in which situation which obligation is appropriate.**

1. Introduction

The ERG has prepared a draft Opinion on proposed changes to Commission Recommendation 98/322/EC of 8 April 1998 on interconnection in a liberalised telecommunications market (Part 2 – Accounting separation and cost accounting) in order to bring it in line with the requirements of the new regulatory framework. This draft document was published by the ERG for comments prior to its finalising.

The present opinion paper states the opinion of T-Mobile on the draft document.

It particularly addresses the following first question of clause 3 of the opinion paper:

Do you agree that the proposed changes to text of the Recommendation as set out in the draft ERG Opinion addresses correctly, in general, the issue of cost accounting and accounting separation obligations, or do you think that is there any part that should be expanded/reduced?

2. General Remarks

The comments made in this opinion paper do not imply any acceptance whatsoever of the application of accounting separation or specific cost accounting rules to the mobile telecommunications sector. It is T-Mobile strong belief, that the introduction of accounting separation and specific cost accounting rules to the mobile sector would not only be in contradiction with the EU-legal framework, but it would also be unjustified and inappropriate.

3. **Remarks concerning the introduction of accounting separation for mobile telecommunications operators**

□ **The introduction of accounting separation would be an inappropriate instrument for mobile markets and would lead to overregulation**

The primordial object of accounting separation were fixed network incumbents at the time of market opening – not mobile operators on a competitive market. The objective was to distinguish the incumbent's bottleneck wholesale services from retail products in terms of revenues and costs. Since mobile operators only offer wholesale products on a very limited scale accounting separation would be a inappropriate instrument for mobile markets. The accounting separation framework does neither match the structure of mobile operators business nor do its major goals apply to the mobile sector.

The accounting separation framework was designed to match the particularities of fixed incumbent carriers at a time when the market was to be liberalised. The most important objective was to facilitate the establishment of the wholesale business in order to allow new entrants to use bottleneck facilities. The approach was designed to force fixed network incumbents to separately show costs and revenues of different wholesale services such as local, single and double transit interconnection, unbundled network elements and leased lines.

Mobile carriers today have a completely different business model as fixed network operators had at the time of liberalisation. The wholesale business for mobile operators is less significant and mobile operators do not provide essential bottleneck network facilities to enable market entry by new competitors.

Imposing the Accounting Separation framework on mobile carriers is therefore blurred and inappropriate as the major reason for its design is missing in the first place. Instead the ERG should focus on light handed less burdensome regulatory remedies to address market failures – if these are identified at all. Unfortunately, little effort has been put into finding light handed ways to address mobile market issues.

□ **The introduction of accounting separation is a severe remedy which may only be imposed after the conduct of a market analysis and the designation of SMP**

Accounting separation is a severe remedy which imposes a high burden on the operators concerned. It is not a light handed approach for data gathering but induces high costs. Furthermore, an operator's flexibility to immediately react to market demands would be reduced to the detriment consumers.

One major principle of the new regulatory framework is that regulatory decisions must be reasoned and based on the nature of the problem. The Framework Directive previews, that the NRA should first determine if an enterprise holds SMP on a relevant market before a decision on the imposition of remedies is taken. The Framework Directive previews a three step approach of SMP designation and the subsequent imposition of remedies:

- a) Market definition of the relevant market
- b) Market analysis: designation of SMP operator(s) and
- c) Choice of remedy: imposition of obligation(s).

If an operator is found to be dominant (either individually or jointly), one specific obligation should be imposed, which must be proportionate to remedy the problem, justified in the light of the objectives stipulated in Art. 8 Framework Directive and based on the nature of the problem.

The imposition of an accounting separation obligation according to Art. 11 Access Directive can only be the final step in the above mentioned procedure. Nevertheless, the ERG draft appears to reverse this logic: First the remedy would be established and in a second step the National Regulatory Authorities would determine, whether an operator does in fact exercise SMP and is subject to the remedy. Hence, the remedy would be chosen without any consideration whether its imposition is the appropriate measure. Accounting separation is far from being a generally suitable instrument for information gathering, as the ERG seems to suggest by its references to Art. 5 of the Framework Directive, but a specific remedy only applicable to SMP-undertakings on a specific market where deemed appropriate as a result of the above-mentioned process. Though the present regulatory framework should increase the National Regulatory Authorities flexibility and choice on the appropriate remedy the present draft appears to reduce this choice.

❑ The introduction of accounting separation for mobile operators would impose considerable costs.

The costs of designing, implementing and updating an accounting separation framework in the mobile sector are considerably high. Apart from the costs associated with designing IT systems, workload etc. several problems that remain unaddressed in the ERG proposal have to be solved. Moreover, there are considerable difficulties in applying cost accounting methodologies to an industry characterized by rapid organisational changes and complex cost causality relations.

Accounting separation is an extremely intrusive remedy for the regulated firm, because it is not in line with modern standards of accounting. Modern accounting systems are designed to run the firm efficiently from an incentive point of view. To achieve this, they

do not anymore rely on fully allocated costs as it serves as the bases for accounting separation. Instead, accounting systems today are designed according to a number of Key Performance Indicators (KPI).

Therefore, imposing accounting separation implies the implementation of a dual book for regulatory purposes only. Such an introduction of regulatory financial statements requires a lot of additional resources, creates a need for additional accounting processes including the corresponding hard- and software and is therefore very costly. Especially generating additional data which is not used for business purposes and constantly checking on the mid-term evolution of this data is extremely resource intensive.

The burden of imposing accounting separation is even higher when taking into account the obligation of auditing and publication of accounts foreseen in the Consultation document (in contrast to the Accounting Separation Framework recommended by the European Commission in 1998). This would create some completely transparent operators within the national markets. Cost structures which are usually regarded as being confidential commercial information would be published, creating a competitive disadvantage in non regulated markets.

Based on international experiences made in implementing accounting separation T-Mobile estimates that at least a 2 digit Mio € amount has to be invested for each company subject to this obligation. It should be kept in mind that the costs comprise not only the set-up costs but also costs for maintaining, operating and updating the systems. Furthermore, the costs involved will be the higher the more complex the prescribed cost accounting system will be.

Mobile operators could not easily compensate for these costs since it is questionable whether it could be recovered in the competitive retail market. Therefore, these costs would directly impact on EBITDA and would induce a deterioration of global competitiveness.

- **The cost of the introduction of accounting separation for the operators and the NRAs would exceed the benefits and would contradict the recent EU action plan on regulatory reform and reduction of administrative burden**

Taking into account the huge costs of imposing accounting separation and, furthermore, accounting for the fact that only few mobile wholesale markets are potential candidates for further investigation and SMP designation, the ERG proposal is clearly disproportionate: The framework covers all activities of mobile operators while only a small part of the business is subject to regulatory intervention. More proportionate remedies would include the transparency obligation (Art. 9 Access Directive) and the Non-discrimination obligation (Art. 10 AD). Even if in some countries regulatory tariff setting would be applied, benchmarking could be considered since it constitutes a far less burdensome remedy.

Furthermore, the introduction of obligations where costs exceed benefits is in clear contradiction to the recent EU joint initiative on regulatory reform. The Irish, Dutch Luxembourg and British Presidencies have agreed on a joint initiative to prioritise regulatory reform over the course of 2004 and 2005. In their letter from January 24th, 2004 they state the necessity to reduce the administrative burden for companies, to apply an impact assessment and to pro-actively use competition policy.

T-Mobile again would like to stress the principle that regulatory decisions must be proportionate, reasoned and based on the nature of the problem. This principle also expands on the regulatory options assessment and the extent to which remedies are necessary.

❑ **The introduction of Accounting Separation and specific rules for cost accounting for mobile operators would be disproportionate and an inappropriate limitation of their economic autonomy**

Proportionality of administrative acts is a basic standard of administrative and European law. The extension of accounting separation and specific cost accounting rules to mobile operators is disproportionate:

- ❑ In the context of mobile telecommunication markets the obligation of Accounting Separation is unable to meet its own inherent objective: The approach of Accounting Separation was designed to separately show the financial aspects of retail and wholesale business in terms of revenues and costs of fixed line incumbents at the time of liberalisation. Since there is only limited wholesale business as such in the mobile network sector, the obligation of accounting separation cannot reach its inherent objective.
- ❑ A chosen remedy should be effective - it should solve the lack of competition. In the case of accounting separation for mobile operators we do not see on how to achieve this effectiveness: It is unclear how these remedies shall solve any existing lack of competition.
- ❑ The intensity of the intervention is out of proportion to the objective of the intervention. The National Regulatory Authorities should always choose that remedy which constitutes the lightest intervention considering the objective of the intervention. Accounting separation is an extremely intrusive intervention in the rights of the mobile operators because it does not only affect one service offering (or the price of this) but the whole company, all its products, its procedures and its financial system. All the latter have to be adapted to this intervention. These major investments and the changes of a multitude business processes cannot be justified by the fact that he might exercise SMP on one particular market.
- ❑ Finally the remedy of Accounting Separation and Cost Accounting for mobile operators is considered to be disproportionate because the National Regulatory Authorities have a multitude of less interfering remedies. National Regulatory Authorities should consider alternative remedies where possible and choose the

least burdensome effective remedy. There is no apparent reason why NRAs should make use of such a heavy-handed instrument.

□ **Accounting separation is not an appropriate tool for the regulation of new industries such as the mobile telecommunications markets**

Accounting Separation and Cost Accounting is a rigid system which allows only limited options of including new services. The proposed Accounting Separation framework and Cost Accounting rules do not fit the particular economic and financial prerequisites of mobile telecommunications markets.

These markets are dominated by a rapid development of new technologies and services. Those new services, which are the essential market driver, could only be incorporated under great difficulties into an inflexible accounting separation framework. Therefore its imposition would not only create heavy burdens on the operators, it would also hamper the entrepreneurial development of these markets.

4. Remarks concerning the proposed methods of cost accounting

The consultation document bundles several cost accounting methodologies to the accounting separation framework. Even if one would accept that accounting separation is a proportionate remedy (what it is not as shown before) the question remains why this framework should in any case be unnecessarily be combined with specific cost accounting techniques and methodologies.

The latter being essential additional remedies – mostly designed for the fixed network in order to facilitate service competition and market entry of new competitors. In terms of foreseen remedies in the Access Directive the consultation paper at least bundles the separate obligations foreseen in Art. 9, Art. 10, Art. 11 and Art. 13. This strongly reflects the ONP approach which should be abolished by the new framework.

Imposition of each of these additional obligations is only justified if this is proportionate to remedy the problem, justified in the light of the Art. 8 Framework Directive objectives and is based on the nature of the problem. Moreover, public consultation on each of these methods would be necessary before designing them.

Instead of proposing a comprehensive one-fits-all framework which automatically includes transparency, non-discrimination, cost accounting, accounting separation and price control obligations the ERG should follow an approach of remedy separation and carefully analyse in which situation which obligation is appropriate.

Concerning the different remedies bundled to the accounting separation framework the following remarks should be taken into account:

- ❑ **The activity based costing method is foreseen as an integral part of the proposed Accounting Separation framework. It is further stressed that 90% of all costs can be indirectly attributed after having implemented this method.**

The implementation of an Activity Based Costing system is a very time-consuming, complex and foremost costly undertaking. In the mobile industry these burdens are particularly severe as the cost structure is characterized by rapid changes, a high proportion of operating costs and a very complex pattern of cost causality which cannot be adequately captured by simplistic allocation rules. As designing Activity Based Costing systems would impose huge costs the decision to implement this methodology should be left to the operators concerned.

The paper doesn't state how the figure 90% is determined. To our knowledge this figure was firstly mentioned by the Arthur Anderson Report to the European Commission

“Accounting Separation in the context of Open Network Provision”, October 1997 which notes that *“The Federal Communications Commission, for example, has stated that it believes that a well-designed cost allocation system may enable 80-90% of costs to be allocated...”*. For reasons not specified the upper limit of this range was then included in the Recommendation of the European Commission on Accounting Separation of 1998 which addressed former fixed network monopolists.

These sources show that again the ERG proposal was drawn with reference to the fixed market and does not account for the specific situation of mobile carriers which have totally different cost structures: For example mobile operators have far higher customer acquisition and retention costs which (i) have far more complex cost drivers than those of fixed network operators and (ii) are not causally related to a specific service. Before making quantitative estimations like the one stated above the subject should therefore be carefully analysed.

❑ **Common cost allocation**

The consultation paper recommends a specific methodology to allocate common costs. Even if cost accounting obligations would be accepted as being a proportionate obligation the question of how allocating common costs should be subject to a public consultation.

The paper again dismisses Ramsey pricing as “practically unfeasible”. The practical difficulties of collecting data to enable the use of Ramsey pricing are often exaggerated and may in fact be less than that required to build a robust alternative model. T-Mobile believes that it is not yet possible to dismiss Ramsey pricing in the way that the paper does.

❑ **WACC**

Mobile markets are characterised by especially high business risks as new technologies and services are constantly developed and implemented. This has implications for the market risk operators are facing. Hence, orientation towards the terms and conditions of capital markets should not only include the average cost of capital and the costs of equity and debt but as well different risks.

The WACC should be calculated using the market values of equity and debt. Book values are not suited to reflect the terms and conditions of capital markets. Furthermore the recommendation should contain a clear preference for using a market oriented method like CAPM when calculating the costs of equity and debt.

Before making recommendations on how the costs of capital should be calculated when applying “hard touch” remedies these points should be subject to an intense industry consultation.

□ **Auditing**

In contrast to the Accounting Separation Framework recommended by the European Commission in 1998 the new ERG proposal foresees external auditing.

This is yet another measure that should be equally applied to all entities subject to the proposal. It can moreover be assumed, that the auditing requirement should cover the additional cost accounting obligations that are bundled with the pure accounting separation framework.

It should be clear that external audits involve high costs and organisational workloads for operators. We cannot see any justification for such a burdensome obligation in the light of the Art. 8 Framework Directive objectives.

Even at times the fixed market was opened up for competition the Commission did not recommend an auditing requirement for former fixed network monopolists.

□ **LRIC**

LRIC modelling is one of several possible approaches which may be used to calculate "efficient" access prices. Generally however, cost-orientation must be considered as a particularly intrusive measure where a State body (the NRA) takes-over one of the most important functions of market competition, namely the finding of prices. In dynamic and competitive industries, such as the mobile industry, it is hard to see how State bodies can possibly perform better than market players in achieving efficient results. If necessary and justified other remedies to determine prices, particularly benchmarking, would be less intrusive.

Mobile markets are dynamic evolving markets subject to rapid and drastic technological changes. Mobile operators and their shareholders incur a high degree of risk arising from the accumulation of substantial sunk costs far before demand emerges, significant uncertainty as to the development of demand, the uncertain pace and direction of technological change and the unclear evolution of the market. Also, mobile markets involve highly complex network design processes. The existence of significant risks imply that LRIC oriented prices may be generally inappropriate for dynamic industries as it is likely to understate the return required for investment in the industry and the substantial risk to the economy if the prices are set incorrectly in a dynamic industry. This risk is the higher the more investment is required in the long-run.