



**RESPONSE TO TRA'S "REBALANCING FOR FIXED SERVICES AND PRICE
MONITORING – DRAFT STATEMENT"**

SUBMISSION

BY

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Executive Summary

1. On 31 May 2009, the TRA released a Draft Statement to seek Licensed Operator's views on Rebalancing for Fixed Services and Price Monitoring (the "**Draft Statement**"). The TRA comments in the Draft Statement:

"Historically around the world, telecommunications tariffs for fixed services of operators insulated from competition have seldom closely reflected the underlying costs of provision."

2. Government social policy in most countries typically meant the prices for customer access services such as telephone line rental (and potentially local calls) were set below cost while the prices for international calls (and in some cases, long distance domestic calls) were set above cost. Below-cost telephone line rental enabled affordable subscription, driving up teledensity, while profits on above-cost calls were used to cross-subsidize the loss on the customer access services.
3. On the introduction of competition, this model becomes unsustainable. New entrants would "cherry pick" the most profitable services, leaving the incumbent operator with an inequitable and potentially unsustainable loss on the below-cost services. The traditional solution to such pricing imbalances, widely used in developed economies across the world, was to require or allow incumbent operators to "rebalance" their tariffs, namely increase access prices and reduce voice prices.
4. Bahrain's model had a great deal in common with the typical scenario. Batelco offered PSTN access services (line rental) materially below the cost of provision, and cross subsidized the loss through profits from its voice services, and in particular from international calls. Batelco's pricing decisions were government policy in relation to a majority state-owned exclusive service provider. Since the introduction of competition in 2003, when Batelco supported the traditional solution, the TRA has neither mandated nor allowed the typical rebalancing solution in Bahrain. Batelco acknowledges that the TRA made some significant steps towards that solution many years ago.

5. Since 2004 Batelco has faced increasing, and in many cases considerable, competition in all markets. There have been significant reductions in tariffs for voice services, and in particular international calls (and despite these reductions, a very significant loss of market share). However, access charges have remained constant.
6. Therefore, typical rebalancing is no longer feasible. There is limited scope for further reductions in voice pricing to “balance” against higher access charges.
7. In addition, the market and technology have changed considerably. The widespread use of bundling, mass-market mobile offerings, broadband technologies and the launch of competing Wimax infrastructures have changed the market dynamics considerably, compared to a traditional rebalancing scenario.
8. In the same way that the development of traditional rebalancing models took into account the likely points of market entry for competitors, a rational plan for Bahrain must take into account the current and likely future dynamics of the market. Here (as elsewhere) new entrants are likely to have an increasing focus on the provision of bundled voice, broadband and mobile propositions. While some new entrants have targeted international voice (“cherry picking”, no less), Batelco is not aware of any new entrant which simply looks to compete on PSTN access services.
9. It is no longer relevant to analyze profitability on a product-by-product basis. A more relevant approach could be to assess the total profitability of products generally used and sold together to determine the scope for sustainable competition. Rebalancing will only be relevant if the total profitability of the relevant product set is such that market distortions are likely to emerge. Any solution should specifically target such a distortion.
10. Batelco also notes that the TRA appears to favor an approach that ties rebalancing to the issue of time based charging for voice services. Batelco considers that there is no relationship between the two issues; the need (or otherwise) for rebalancing is based on the need to set the appropriate incentives for competitive entry. The basis on which voice calls are charged for is irrelevant in this context provided tariffs do not distort competition. The use of per second, per minute or pulse charging is an issue of a purely commercial scope and should therefore be addressed outside the scope of rebalancing.

11. Batelco notes that there have always been cogent arguments against rebalancing on grounds of social equity. The effects of competition do not benefit all users equally. Users with low income and low spend on telephony services will be disproportionately hit if a traditional rebalancing approach is taken as they take few or no other products on which they can receive an offsetting price decrease. Though mobile does offer the possibility for low monthly spend, users will face an increase in costs from handset acquisition and replacement. Mobile voice tariffs are moreover still such that even households with low usage would experience an increase in spend if they switched to mobile in response to higher PSTN line rental. Traditional rebalancing therefore poses a threat to the most vulnerable users.
12. The TRA is suggesting a compensation scheme for low usage households to mitigate potential adverse effects of a traditional rebalancing. It is not clear to Batelco exactly how such a scheme would work and who eventually would cover the costs. Further, the costs of the scheme will clearly depend on the extent of any rebalancing scheme (if any). Batelco therefore finds that this option should be thoroughly discussed before additional administration costs are incurred and government budgets burdened with subsidies.
13. Batelco recognizes the concept of rebalancing, but considers that, given the competitive and technological development in telecoms and in the Bahraini market, the case for a traditional rebalancing process in Bahrain at the current time is not clear. Rebalancing is in some respects a legacy solution to legacy competition issues. In today's world of successful competitors in Bahrain providing bundled fixed, mobile, and broadband services over competitive infrastructures and/or wholesale broadband access products it is not clear that it is still relevant.
14. If the TRA does consider that rebalancing is necessary then due consideration should be given to the appropriate set of products included in the overall profitability calculation (most likely including access, voice and data), and these must be defined before the need for rebalancing can be determined and an appropriate time horizon set. If a legacy approach to rebalancing is taken, the 3-4 year time horizon suggested by the TRA seems inappropriate considering that similar processes have taken more than 10 years under less uncertain circumstances in other jurisdictions.
15. The rest of this submission addresses the TRA's question in order.

16. This submission is made by Bahrain Telecommunications Company (Batelco) BSC (Batelco). The contact details are:

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Detailed response to TRA's Questions TRA's

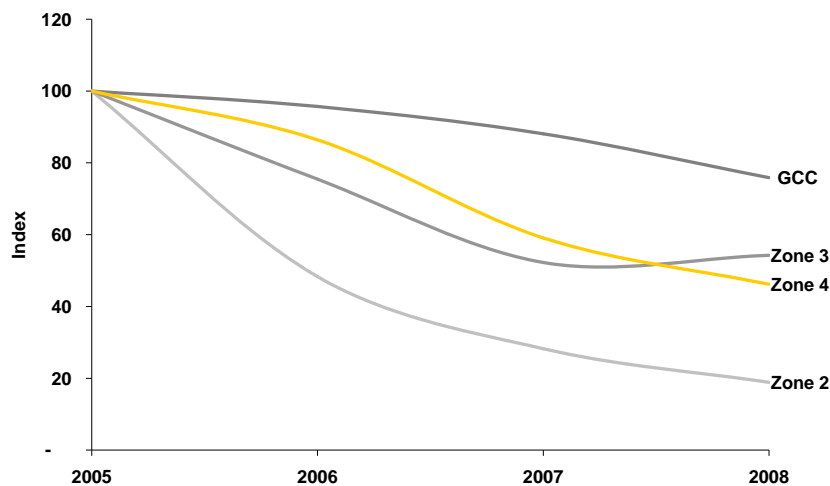
Question 1: Do you have any comments regarding the rationale for and objectives of allowing fixed line tariffs to move closer to costs? Please elaborate

17. Tariff imbalances between line rental and voice tariffs traditionally result from policies that sought to encourage consumers to connect to the fixed telecommunications network at a time when this was owned and managed by a (often state-owned) monopolist. Network externalities and equity considerations led to pricing access services at levels, which, rather than being cost-based, could be affordable for a majority of citizens. Long-distance and international calls were typically priced above costs to compensate for this.
18. As correctly highlighted by TRA, an unbalanced price structure could give distorted price signals for investment in such a scenario. In turn, this may attract competition in market segments where profitability appears higher while reducing investment in services where returns are low. Specifically, distortions arose because prices for access services such as PSTN Line rental and connection were typically set below cost, while prices for voice services, and in particular international calls were set above cost.
19. This is the situation that prevailed in Bahrain on liberalization in 2003, with Batelco incurring a loss on the provision of PSTN line rental, and using profits achieved on international calls to compensate for this loss.
20. The traditional solution to such distortions has been for the regulator to allow the operator to "rebalance". Prices for access services were increased over time to move in line with costs and at the same time the price of voice services were reduced to reduce the impact on end users, and to prepare for competition in voice markets and eventually in access.
21. As described by the TRA in Section 6 of its Draft Statement, rebalancing usually takes place in the early stages of liberalization. For instance, in the UK rebalancing took place when BT was privatized but before the duopoly review, when the market

was effectively opened to competition. The process was gradual and lasted for almost two decades. In addition, it was largely implemented by BT in the context of retail price caps, which covered baskets (from 1984 to 1997) rather than individual services. As a result, BT had sufficient flexibility to adjust prices across services.¹

22. In Bahrain, the price of calls has already fallen under competitive pressure while line rental has remained low, when compared with costs or international benchmarks, as discussed in Section 5 of the Draft Statement. The dramatic reductions in international call prices subsequent to the market opening are illustrated in Figure 1. The official policy of not addressing rebalancing before the introduction of competition has therefore led to a situation where the typical levers for rebalancing are no longer available. The scope for traditional rebalancing is therefore no longer present.

Figure 1: Indexed average international voice tariffs



Source: Batelco calculations based on "Telecommunications markets indicators in the Kingdom of Bahrain" (TRA)

23. This stage of market development differs significantly from the standard situation in which rebalancing would be applied and, for this reason, calls for careful consideration of the specificities of the Bahraini market.

¹ Oxera, *Structure of Royal Mail's Controls: Lessons from BT's Price Controls*, Report prepared for Royal Mail, September 2005.

24. In particular, the implications of changes in rental charges for overall consumption patterns should be analyzed. Batelco agrees with the remarks in paragraph 34 of the Draft Statement, where the TRA emphasizes that the access deficit should be assessed not only with reference to “connection and rental” services but also with other services that share the local loop as a production input.
25. Batelco is not familiar with any alternative operator globally that offers line rental on a stand-alone basis. On the contrary, the trend is clearly for operators, entrants as well as incumbents, to compete for full customer relationships including access, voice and internet. Given this market development, it is questionable whether the traditional mix of relatively low line rental and relatively high voice usage prices lead to any distortion at all as it is the total customer profitability that drives competition.
26. Moreover, at the current stage of market development, in the absence of a comprehensive analysis of the competitive situation, full rebalancing might distort competition between fixed and mobile communications. As acknowledged by the TRA in paragraph 40 of the Draft Statement, mobile services could constrain the sustainable price level in the fixed market.
27. In mobile markets, access, voice and data services are provided together across a great variety of integrated price plans where the total price depends on the combination of products taken. The same applies to Wimax based services and competitors providing broadband services, and potentially voice through VoIP offerings based on wholesale products provided by Batelco. Users hence do not face a market where access, voice and data services are provided as separate services in separate markets where each operator seeks to position itself with independent offerings in each market (with the exception of international voice). A rebalancing requirement between products that are sold and used together would add distorting constraints on pricing and effectively block Batelco from offering different combinations of line rental and voice minutes that can be offered on competing platforms and that are common practice in fixed line markets eg, in Europe. This should be reflected in the assessment of the need for rebalancing.
28. This is consistent with the TRA’s view, in paragraph 37 of the Draft Statement, that:

“operators may choose not to rebalance fully while seeking an overall reasonable return over the services that can be provided over access lines.”

29. Moreover, substantial and rapid changes in price levels as a result of regulation may have unintended consequences on the market. For instance, if a significant number of households disconnected and became mobile-only subscribers, this may alter the structure of the telecommunications market. Batelco would like to encourage the TRA to analyze the overall implications of rebalancing on the sector and ideally provide quantitative estimates of its expected impact to avoid the risk of implementing a legacy solution to a legacy problem after the market has moved on.
30. In addition to demand-side considerations, one may also observe that fixed access and DSL share common inputs on the supply side. The copper loop is a common cost for line rental and DSL access, which complicates the analysis of the costs and revenues that should be taken into account in a price rebalancing exercise. Traditionally in regulatory costing exercises, the entire copper costs have been allocated to PSTN line rental. Such an approach makes sense in a legacy world where the copper loop existed prior to the development of broadband. However, in a world where the primary driver of access revenue is through the provision of broadband via ADSL over the copper loop, some consideration should be given to the distribution of the copper costs between voice and data.
31. Batelco notes that such questions around allocation of common costs to products are likely to become increasingly relevant in a move towards IP based networks where common platforms can support multiple products. The legacy approach to cost allocation will therefore have to be reviewed, and flexible approaches to product costing will need to be adopted by regulators.
32. Finally, converging markets, economies of scope, emergence of competing network platforms and the resulting increasing competitive pressure continue to change market dynamics. Operators hence face much more uncertainty today than in the simpler “access and voice”-world in which rebalancing has typically been implemented. The higher pace of development increases the risk that a traditional rebalancing plan introduces rather than corrects distortions, as pricing decisions are artificially restricted.

33. In summary, Batelco finds that a legacy definition of rebalancing would not properly reflect current and expected market dynamics and the nature of the cost base. A new definition of rebalancing properly accounting for these should therefore be agreed upon before any regulatory intervention is proposed.

Question 2: Do you have any comments regarding access to and affordability of basic voice telecommunications services? Please elaborate

34. In Section 7 of the Draft Statement, TRA discusses the expected impact of rebalancing on consumers. Residential customers are the focus of TRA's comments, given that they are more likely to be affected than business customers by price increases for basic telecommunications services. This is analyzed in terms of penetration of basic voice services by income level and affordability of fixed services in comparison with mobile phones.

35. Regarding penetration, the role of mobile phones in furthering access to telecommunications services is widely recognized, especially in low and middle-income countries. According to ITU figures, fixed penetration worldwide was about 19%, compared with mobile penetration of about 50% at the end of 2007. Differences between the penetration of fixed and mobile networks are therefore expected.

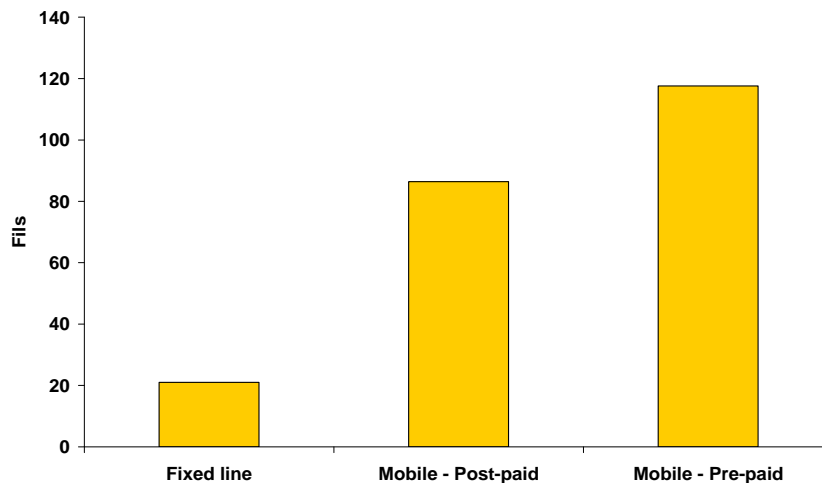
36. The Draft Statement, especially Section 9, focuses in particular on low-income households. In most jurisdictions low-income consumers have remained the target of support initiatives even after rebalancing has taken place.

37. For instance, in the US Linkup and Lifeline are aimed at low-income households even if fixed line penetration is among the highest in the world. In the state with lowest penetration, Mississippi, overall penetration is 90% while it is under 80% for low-income households. Given the high levels of penetration, the rationale for this type of support is likely to be related to equity considerations rather than motivated by the exploitation of network externalities.

38. This picture is in contrast with the data provided by TRA on Bahraini low-income households. Penetration rates for this income group, which is around 16% are significantly lower than the 87% level for Bahraini households in general.

39. Regarding affordability, Batelco agrees with TRA about the competitive constraints provided by alternatives to fixed access, but is concerned about the effective degree of substitution with mobile services for this segment of the market. A comparison of average prices for local calls reveal that mobile is significantly higher priced per minute. Mobile is hence more expensive than fixed line even for very low call volumes.

Figure 2: average prices for 180 second call to fixed line



Source: Batelco

40. In Figure 4 in the Draft Statement the cost of owning a mobile phone is compared with fixed line rental, while Figure 5 displays the prices of some fixed and mobile baskets in relation to two different levels of household income.

41. While these figures show that some basic phone baskets represent a low ratio of income, no information is provided as to disposable income once expenditure on essential and fixed costs (e.g. rent, food) is taken into account. As a result, it is difficult to draw conclusions on affordability on this basis and this might be especially important for households that are already cash-constrained and might have no other alternative than to migrate to mobile services. An indication of the potential relative

impact for such families is that, despite the low access charges, they already have a low usage of a product with low marginal costs. That signals particular vulnerability and risk of exclusion even for modest price increases for this segment.

42. Batelco considers that any comparison between the costs of fixed and mobile should take into account all costs. In particular, it is not clear from the TRA's analysis that they have accounted for the costs of mobile handsets. Mobile handsets usually have a shorter life than fixed line telephones, and are typically expensive. This can significantly add to the costs experienced by low income/low usage users. Further, the cost of handset acquisition and replacement cannot be captured simply by the inclusion of an average amortized cost for handsets in the monthly spend calculation. The lumpy nature of handset expenditure can in itself function as a barrier for cash strained users, and this should be considered in any assessment of the affordability of mobile services relative to fixed services.

Question 3: Do you have any comments regarding the proposed broad parameters for Batelco to prepare a rebalancing plan? Please elaborate

43. In the Draft Statement, Section 8, TRA invites Batelco to submit a rebalancing plan and defines a list of principles that such plan should follow. In the following, Batelco will address the following issues arising from the TRA's proposal:

- Time horizon for rebalancing;
- Market development and risk;
- Social impact;
- Wholesale pricing; and
- Relevant time unit for charging.

Time horizon

44. In paragraph 55 of the Draft Statement, the TRA states that *“three to four years to be a suitable timeframe”* for rebalancing.

45. As noted in Batelco's response to Question 1, Batelco finds that an appropriate definition of rebalancing that accounts properly for market dynamics needs to be

agreed before a rebalancing plan can be developed. Only once such definition is in place and a view of the need for rebalancing is known, an appropriate time horizon can be established.

46. However, if a legacy rebalancing view is adopted, the suggested 3-4 years time horizon appears overly optimistic in light of the extent of the access deficit in Bahrain and international experience.

47. The UK the rebalancing process lasted decades. Similarly, in the US rates were still being rebalanced in 1996 at the time of the Telecommunications Act, long after the 1984 divestiture had initiated the dramatic reduction of inter-state toll prices and the increase in local call prices. In New Zealand, the incumbent increased its line rental even before liberalization (1989) and privatization (1990).

Market development and risk

48. Batelco considers that, given the uncertainties and the potential interplay with mobile, impact on income, and WIMAX, there may be an argument for a delay in rebalancing to assess the impact of current market developments. Tariff rebalancing is essentially a legacy solution to a legacy problem. In today's more dynamic telecoms markets there is considerable risk that a rapid rebalancing programme could create adverse distortions in the market. Further, there is a risk that Batelco and the TRA may not have time to reverse course in response to signs of adverse impacts on the market.

Social impact

49. Batelco shares TRA's desire *"to cushion the effect of rebalancing on users"*. However, given the very low level of call charges for fixed telephony and the substantial access deficit, the scope for compensating significant increases in line rental appears limited. For households that currently have receive-only subscriptions and therefore do not make outgoing calls, rebalancing would pose additional challenges. This further supports the argument to assess the total profitability a reference product group or basket to determine the scope for rebalancing rather than an individual product profitability assessment.

Wholesale pricing

50. In Paragraph 58 of the Draft Statement the TRA position appears to be that low retail pricing should feed into low pricing for wholesale inputs. Batelco notes that, in terms of the link between retail and wholesale prices for copper lines, unbundled access is not only an input for voice services but also for the provision of retail broadband services.
51. Therefore, an approach in line with international practice would be to analyze the consistency between the pricing of wholesale unbundled access, wholesale broadband access, and there related retail offerings namely retail DSL pricing. In view of this, some copper costs should form the cost basis for DSL given that it is a shared input. A simple comparison of wholesale unbundled access with retail PSTN line rental would be inappropriate as it would ignore the fact that most alternative operators who seek to unbundle primarily do so to provide broadband services or bundled broadband and voice not a stand alone PSTN line rental product.
52. The validity of the approach to assess appropriateness of relative wholesale and retail prices across the entire product set rather than on a product by product basis is confirmed by the European Commission's approach in its investigation of Deutsche Telekom for margin squeeze on PSTN access². The Commission included the impact not only of PSTN but also ISDN and DSL in its test. The Commission states:
- “The comparable wholesale and retail services are found to be fully unbundled local loop access and retail access in all its variants, i.e. analogue, ISDN and ADSL”*
53. Based on European experience, the TRA should consider a broader standard when assessing the relationship between wholesale and retail products.

² COMMISSION DECISION of 21 May 2003 relating to a proceeding under Article 82 of the EC Treaty (Case COMP/C-1/37.451, 37.578, 37.579 — Deutsche Telekom AG)

Relevant time unit for charging

54. The TRA brings up the possibility to gradually move away from pulse based charging towards per second charging as part of rebalancing. Batelco does not consider there to be any relationship between the two issues, and therefore would not consider that the issue of time based charging is relevant in the context of a discussion on rebalancing. Rebalancing is a regulatory mechanism by which retail pricing distortions are removed to create the appropriate incentives for market entry. The decision on which basis an operator seeks to charge for its voice service should be considered a purely commercial decision and hence is outside the scope of regulation.
55. There is international practice for either method and one method cannot be said to be superior from a commercial or consumer protection point of view. Different billing structures favor different user profiles and there is not one method that will make all users better off. Users can indicate their preference for billing increments through the choice of supplier and products in the market. Billing increments should therefore be a commercial decision in response to user preferences rather than a regulatory decision.
56. The TRA can facilitate such a consumer driven development by lifting the tariff approval regime rather than making it more onerous as otherwise proposed. That would contribute to more choice for users through more dynamic competition rather than the TRA dictating the detailed design of products on behalf of users.

Summary

57. Batelco hence recognizes the concept of rebalancing, but considers that, given the competitive and technological development in telecoms and in the Bahraini market, the case for a rebalancing process in Bahrain at the current time is not clear. Rebalancing is in some respects a legacy solution to a legacy competition issues. In today's world of successful competitors in Bahrain providing bundled fixed, mobile, and broadband services over competitive infrastructures and/or wholesale broadband access products it is not clear that it is still relevant.

Question 4: Do you have any comments regarding the proposed approach to deal with the needs of low income users? Please elaborate

58. Following the Government's recommendations, TRA suggests protecting low-income subscribers by a *'direct demand-side subsidy'* (Section 9 of the Draft Statement, paragraph 67).

59. For Batelco, this mechanism would have the benefit of not requiring additional analysis within the rebalancing plan and would also be managed externally.

60. However, it is not clear how the system would be implemented, which would raise questions as to the transitional arrangements to insure that low-income households would not be affected by service interruptions. The details of any subsidy scheme would be crucial in assessing its effectiveness and desirability. In paragraph 68 of the Draft Statement, TRA mentions that this subsidy would be *'competitively neutral'*, which suggests it would be directly allocated to consumers. In this case, one would have to ensure that the subsidy was not resold (if a voucher) or used to buy other products. Additional clarity around who should test for eligibility for the subsidy, the basis for calculation of the subsidy, and potential administrative burdens resulting from the compensation scheme are necessary before Batelco can assess its potential impact.

61. Finally, if funding (paragraph 70) was provided through the TRA budget then part of this would effectively come from the communications industry and hence mostly from Batelco. The scheme may therefore end up adding administrative costs while Batelco will continue to pay for potentially uneconomic users. It is not obvious what the benefit then would be.

62. Once again Batelco would like to direct the TRA's attention to the merit of taking the view that sufficient profitability should be assessed across a suitable product set reflective of market practices in competitive markets (i.e. considering access, voice and internet profitability as a whole rather than separately). That would leave considerable scope for the market to cater even to low usage customers' needs

through targeted product development. This would reduce the need for mitigating intervention though e.g., subsidies.

Question 5: Do you have any comments regarding the proposed tariff monitoring framework? Please elaborate

63. The TRA proposes to track price changes on the basis of pre-defined baskets of consumption and sets out a summary of the approach in Section 10 of the Draft Statement. The TRA has defined a range of household types and associated user profiles. The TRA then calculates a measure of aggregate spend for fixed voice, mobile, and internet.

64. The TRA states that the purpose is to:

“assess and track over time the impact of price changes and tariff structures on consumers”.

65. The TRA does not indicate what the purpose of such tracking is or what kind of policy initiatives the TRA may wish to support using data from this tracking.

66. Defining service baskets and monitoring their development is a complex and onerous exercise. For instance, a report for the European Commission provides benchmarks for a variety of broadband packages in Europe and other countries.³ The main challenges are presented by the wide differentiation in the subscription packages available in a given market, e.g. in terms of charge structure. This is further complicated by the continuous changes in product offering in the market that will make year-on-year comparisons difficult.

67. This observation raises the question of the basis on which the baskets listed in Table 1 of the Draft Statement have been constructed and whether they are representative of the Bahraini market. For instance, given the preceding discussion on fixed-mobile

³ Van Dijk Management Consultants, “Broadband Internet Access Costs”, First half of 2008, December 2008.

substitution, it is surprising to find that all except one basket include fixed voice services.

68. Moreover, in Table 2 of the document prices for different services are summed up to give the total monthly spend for the various household types. However, as the market for bundled services develops, it is likely that the price of the bundles will be lower than the sum of the individual prices.

69. In particular for broadband services, where the scope for innovation appears significant in Bahrain, there is the risk that the baskets initially defined may not correspond to the available packages. The problem of rapid quality changes is very well-known in the Information Communication and Technology (ICT) industry and has led to the adoption of quality-adjusted price indexes.

70. As an alternative, the TRA might for instance define one benchmark for stand-alone services (e.g. Basic fixed usage profile, Single – low usage profile) and one for bundles when applicable.

71. Finally, the methodology for measuring price changes, and possibly aggregating them in an overall index, is not described. A simple view of how prices change for a set of products across pre-defined user types will not capture how changing markets e.g., can move users from low to high usage categories. It is not clear how the TRA intends to account for changes in the user mix which in turn will affect competitive pressure differently for different user types.

72. Batelco can therefore not provide a final assessment of the suggested tariff-monitoring framework. Specifically, Batelco would need clarification of:

- What the proposed baskets will be used for;
- The basis on which the TRA identifies the products on which the baskets are build;
- How price changes will be measured; and
- How quality changes are to be captured.