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Comments on IDA Consultation Document issued on 7 January 2002 - "Review of International Settlement Arrangements"

Please find below our comments

## 1. General Comments on the International Accounting Rate System

The international accounting rate system was developed at a time when international telecommunications services were supplied through bilateral correspondent relationships between national monopoly carriers. In fact, the International Accounting Rate System (IARS) has its roots in the early days of telegraphic transmission, dating back to the 1840's when William Morse invented the Electric Telegraph. There is also some evidence to suggest that a form of IARS existed in some European countries prior to 1840 relating to the delivery of hand written telegrams, which were conveyed across country borders by riders on horseback (pony express).

Accounting rates, or 'correspondent arrangements' had always been the usual basis for setting charges between monopolistic international operators for the delivery and termination of international calls. Under this (now antiquated) system, traffic is carried by the originating operator to a notional mid-point on the route and then handed over to the terminating operator. The charge made by the terminating operator is known as the settlement rate, and the sum of the settlement rates in each direction (together with any transit charges) is known as the accounting rate. Usually the two settlement rates are identical, and accounting rates are uniform across the time of day and type of call. A reconciliation is made between the operators at the end of each time period and a payment is made only on the balance of the net traffic flows.

The inappropriateness of the IARS was brought to the attention of the world as far back as 1988, in a book entitled: "When Countries Talk: International Trade In Telecommunications Services". The authors, Aronson and Cowhey, speak of "the ancient regime of telecommunications (consisting) of national monopolies tied together by an international cartel that legally sanctioned administered prices, equal splits of international revenues, and rules that forbid competition for international traffic" and that "strictly controlled entry".

Again, in 1989, the world was shocked by the accusations of price gouging and cartelistic behaviour by the influential Financial Times Telecommunications Correspondent, Hugo Dixon. He wrote of "a pricing system based on an obscure set of accounting practices" established by the "worlds telephone companies in cosy club committees", whose "meetings switch from one capital to another". Other articles produced at around the same time also suggested that these [international telecommunications settlement arrangements] were no longer appropriate in a world of rapidly changing technology and supply and regulatory structures.

Furthermore, it is a well-known fact that the level of accounting rates is usually substantially above the costs which carriers incur to terminate the traffic concerned. It is therefore in the

interests of the operators with a net inflow of traffic to maintain this system, because of the large payments they receive for terminating calls. The high cost of accounting rates is ultimately passed on to consumers, who consequently often pay artificially high prices for international services conveyed under accounting arrangements.

This background information is offered as a backdrop to our comments below on IDA's points 8 (a) to (g).

## 8. IDA seeks views and comments on the following matters:

(a) Are one-way bypass and whipsawing still serious concerns at this point of time?

**Comment:** The potential for anti-competitive behaviour cannot be eliminated entirely, no matter how robust the mechanisms are that measure and monitor it. Once international routes become effectively competitive, there is no longer a need for special provisions to be made to deal with such behaviour.

Whipsawing and one-way bypass are generally only feasible where the far end operator enjoys market power and/or the foreign country does not permit the accounting rate system to be bypassed (e.g. by ISR). Clearly, now that international markets are generally more liberal and more than 70 countries have agreed to the WTO accord, there is much less potential for such practices.

Are there other anti-competitive practices that should be considered?

**Comment:** Refile and Self Correspondence.

At which point of time would these cease to be of concern?

**Comment:** It is our opinion that Singapore should not be overly concerned about these matters as of today. Our opinion is based on the fact that only a small proportion of Singapore's international traffic is exposed to anti-competitive behaviour. We base this assertion on the following facts:

- 35% of Singapore's international traffic goes to Category 1 countries anyway.
- A further 35% of international traffic goes to one country, Malaysia, Singapore's nearest neighbour, the only country with which Singapore has a land border and with which it has a special relationship. Malaysian traffic should therefore be treated by IDA as "regional" and not international.
- Of the remaining 30% of international traffic, 20% of it goes to just four countries in S.E. Asia, namely: Indonesia, China, Thailand and Philippines all of which have reasonably well balanced in/out traffic ratios with Singapore and therefore would find it difficult to invoke any form of anti-competitive behaviour that SingTel would not be able to counter (if it so wished).
- Singapore is therefore only potentially exposed to anti-competitive behaviour on 10% of its international traffic.

What would be the appropriate signals or indicators to ascertain that there is sufficient competition in the market?

**Comment:** We believe that those countries that have signed the WTO BTA should be treated as competitive. Even though, some have not yet fully liberalised their markets, the 'intent' is there and these routes should be considered for retail international calls as effectively competitive (in the business market) and increasingly competitive (in the residential market).

(b) Should the regulator continue to take an ex ante approach or to take an ex post approach instead? What would be circumstances under which ex ante approach would remain relevant or to consider an ex post approach?

**Comment:** Hands off (self-regulation) approach.

(c) How effective, or ineffective, are the parallel accounting and proportionate return measures in addressing the problems of one-way bypass and whipsawing?

**Comment:** The UK experience is instructive. UK licenses contain certain Conditions that require operators to provide evidence to the national regulator (Ofcom) that the principles of parallel accounting and proportionate return are being adhered to on those routes designated as non-competitive by the Director General of Ofcom. Most operators do not complete their returns and those that do can (if they wish) manipulate the figures so as to disguise whipsawing and one way bypass activities. In the former case, Ofcom does not have the resources to chase operators for returns and in the latter case, Ofcom does not have the requisite expertise to assess whether the figures in a return have been manipulated or not, and even if they did, it would be a very costly and time consuming exercise to conduct a full-scale investigation. In addition to this, there are many 'grey' routes between UK and non-liberal countries (mainly via satellite) that carry international traffic which is never statistically accounted for by Ofcom.

Would there be other more appropriate or effective measures that may be considered to achieve the policy goals? Or should there be other complementary measures? Do these measures pose operational constraints on operators? How can these measures be refined to alleviate the regulatory burden on operators?

**Comment:** We have demonstrated in our commentaries above that Singapore is probably only at risk of anti-competitive behaviour on 10% of its international traffic - and then only to non-competitive destinations which have a very strong incumbent monopoly PTT. Given that SingTel still carries a majority of Singapore's international traffic, it would be the first to notice any malpractice being perpetrated by another operator, primarily through sharp changes in traffic volumes which would indicate that some form of bypass was being invoked. The bypass could of course be legal if the traffic has moved to the network of another licensed operator that has rights to convey international traffic to and from Singapore. In the latter case, Singtel would have no cause for complaint but in the former case Singtel has the right to lodge a formal complaint with IDA who would subsequently investigate the transgression.

(d) Would it be useful to continue to require operators to file:

(i) their accounting rates and accounting agreements within one week of the conclusion of the agreement; and

**Comment:** No.

- (ii) the volume of incoming and outgoing traffic on a route-by-route basis for the top 25 destinations on a quarterly basis? Should this requirement be levied on only certain operators to maximise the effectiveness of the measures in place? What would be the appropriate criteria to determine such a group of operators?

**Comment:** Only Significant Market Power (SMP) operators (i.e. those with more than 25% of the international voice services market) should be required to file these returns.

- (e) Would the publishing of the accounting rates and the aggregate figures of all inbound and outbound international traffic volume for Cat II routes be useful to: (i) minimise the potential for anticompetitive arrangements; and (ii) facilitate negotiations between carriers? How would the publication of such rates help to achieve these goals?

**Comment:** Given that a large proportion of Singapore's international voice traffic is already outside the accounting rate system, the effort required by IDA to do this would be disproportionate to the benefits.

- (f) Are there any advantages, or drawbacks, from continuing to impose, or to lift, the parallel accounting and proportionate return for Cat II countries? How would these arise?

**Comment:** In our professional opinion (as a consultancy with its primacy in wholesale markets) we do not consider it possible to estimate accurately the extent to which accounting rates are or may in future be artificially inflated by whipsawing. However, based on current data we have attempted to quantify the potential costs to Singapore of one-way bypass by overseas operators on non-WTO routes. Although the calculations are necessarily very rough, we estimate that the maximum potential cost to Singapore of one-way bypass by such operators would be in the region of **S\$15 million** per year. This represents around **15%** of revenue receipts from overseas operators for incoming international calls and roughly **6%** of total international revenue from retail customers and overseas operators. This rough figure has been arrived at by multiplying the total incoming traffic on each route, by the relevant settlement rate (thus attempting to quantify the maximum potential loss to Singapore operators if all traffic which they currently receive from such routes were terminated by alternative means).

It should be noted that only non-WTO routes have been considered, on the ground that these are the only routes on which the removal of proportionate return conditions could have an impact on Singapore.

It is most likely that operators on WTO routes are already engaging in one-way bypass and so this is a cost which is already being incurred and which would not therefore be affected by lifting parallel accounting and proportionate return conditions. In any case, it is likely that most traffic on non-WTO routes is carried by Singtel anyway and therefore all current incoming traffic from non-WTO routes has been presumed to be potentially subject to one-way bypass (thus quantifying the maximum potential loss).

- (g) What would be the impact of technology developments (e.g. Internet telephony) or indirect access methods and least cost routing (e.g. refile or transit) on the effectiveness of the current measures?

**Comment:** Internet telephony (i.e. voice traffic that is encoded with the Internet Protocol [TCP/IP] rather than encoded with the conventional Pulse Code Modulation (PCM) is deemed to be a data service and is therefore not subject to the rules and regulations that apply to normal voice message services. Therefore, no matter how Internet Telephony is used, whether it be in the fashion of refile, one-way bypass or for whipsawing, it can never be considered to breach of the regulations covering normal voice message services, simply because it is classified as a data service. In addition to this, modern 'soft switches' can be programmed very easily to automatically carry out time-of-day Least Cost Routing which can effectively switch traffic via different hubs around the world to achieve the lowest prices. Therefore, it is our assertion that technology developments will make it increasingly more difficult for IDA to maintain the effectiveness of the current measures.

**### END###**

#### **About Us**

Chameleon Consulting is a part of Arran Associates Ltd, a Global Consulting Practice strategically focused on the dynamics of change, whilst retaining a primacy in wholesale markets and emerging operators in evolving markets.

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