

## General

Digita welcomes the opportunity given by Ficora to express its view on the report "Cost Accounting and Pricing Principles in Finnish Digital TV Transmission" by Europe Economics 09 September 2005, diary number 34/230/2005.

We'd like to thank Europe Economics for a thorough work during the study. In a large number of topics covered we agree with their proposals. In the following we point out issues where Digita's opinion clearly and with supporting arguments differs from the consultants' opinion.

We know that it is difficult to find comparable companies to benchmark Digita's business activities, networks and processes and it is a fact that Digita is one of the very first companies entering the world of digital television and shutting down the Analogue TV networks. Due to this we understand that there is a need to closely cooperate with Ficora when an analysis of our business is conducted. We also trust that Ficora will do their best to put the regulatory measures used into a correct perspective by using only a necessary amount of regulation in areas where it has a significant effect to achieve the objectives of regulation.

## Final Report

For the public consultation some pieces of the chapter 3 have been removed, because it includes a lot of detailed network structure data and confidential information on customer specific solutions. For national security and confidentiality reasons this chapter could not be made public. In connection with the discussion on confidentiality we also pointed out some technical corrections in the draft report. To our disappointment we have learned that a final version of the chapter 3 including corrections has not been written by the consultants. We see a risk in the fact that the full report exists for internal use by Ficora only as a draft version. This will potentially lead to misunderstandings and conclusions drawn on erroneous data. If the report will remain unchanged, it should always be accompanied with Digita's comments 26 August 2005.

## Comments on the background information presented

In Digita's opinion the report does not provide an objective and correct description of the current competitive situation. Cable TV is already a real substitute for DTT in all densely populated areas of Finland. This fact has been ignored in the Europe Economics' report. In practice, a great majority of housing compounds that use shared antenna solutions chooses cable when changing analogue antenna/network solutions to digital technology. This observation is valid despite the fact that traditionally Cable TV and Terrestrial TV are considered different markets. Originally the Communications Market Act had technology neutrality as a clear objective. We'd like to point out once again that the level of regulation in the cable television network services market is significantly lighter than in the terrestrial networks. This gives an unfair competitive advantage to cable television network operators.

As the report points out it is true that potential new licenses for new DTT multiplexes could be granted to someone else than Digita. This would mean that a competitive situation would exist on the market for all components of Digita's currently regulated DTT activities (multiplexing, distribution, transmission) already in 2007. Regulation should be scaled and targeted to make such a market-entry viable, in spite of a full scale of detailed obligations.

## Asset valuation / High Towers / HCA vs. CCA

The report claims that Digita's high towers are a so called essential facility. This may have been the case with analogue TV. As presented in [appendix 1 to Digita's comments to the Final Report 26 Aug 2005](#), this is no longer the case in the digital era. After the ATV switch-off there are no compelling reasons why any new transmitters should be located in Digita's towers.

Valuation of Digita's mast assets at historical cost would lead to unreasonable and random results, especially in a situation where published guidance and several pricing related decisions by Ficora almost without exception are based on a concept of Technical Present Value. This or in broad terms equivalent CCA accounting has been the preferred choice by other European regulators, Ofcom and ARCEP for example. A more complete comparison is presented in [appendix 2 to Digita's comments to the Final Report 26 Aug 2005](#).

The choice between HCA, CCA and Technical Present Value has been analyzed by BearingPoint, we enclose this study as [appendix A](#). BearingPoint concludes that HCA based valuation has serious disadvantages and recommends the use of CCA.

[Appendix B](#), prepared by TERA emphasizes the main advantages and disadvantages of different cost calculation methods (HCA, LRIC, CCA) and demonstrates that the CCA method does not constitute an alternative to the HCA method but a necessary evolution of this latter method allowing to overcome its genuine disadvantages. The report by TERA demonstrates in detail, that a regulation based on historical costs is always considered inadequate and inefficient, independently of the market structure. In particular, in a monopoly situation, the HCA method introduces a distortion in the operator's investment choices and is not an incentive to be either efficient or innovative.



Pricing of site leasing has also a competition related dimension: if Digita would price mast and equipment space prices based on historic cost, we would most likely see complaints by our competitors in commercial radio and telecom site leasing, accusing Digita of predatory pricing.

Most European NRAs as well as the ERG (European Regulators Group) recommend the use of the CCA and not the HCA method for valuing the cost of copper local loop. This method is recommended even though the local loop is considered as an essential facility and the incumbent does not compete on that activity. These Authorities explain that current cost provides appropriate signals to both suppliers and consumers. Considering this, Digita does not agree that current cost could be an appropriate method only if the competition will be developed. Please see [appendix 2 to Digita's comments to the Final Report 26 Aug 2005](#) for further details, as well as above mentioned studies by Bearing Point and TERA.

### **Comments on proposals concerning Cost Allocation Principles**

In general, the consultants have chosen a relatively light approach in evaluating different alternatives for cost allocation. Their argument is that ATV switch-off is only two years away from now, and nothing too complicated is worth the effort. In Digita's case current allocation methodology has been developed for the whole duration of the migration process from analogue to digital television networks, taking place during years 2001-2007.

Logical and fair cost allocation and pricing criteria for shared infrastructure has been a key element in Digita's current pricing. The cause and effect principle works relatively well in the ETV point system and Digita has contractual obligations with several customers to use it in the future years as well. In fact, replacing the current approach with something "more robust and simple" could just lead to customer complaints on discriminatory pricing because we would lose the existing clear connection with technical parameters and prices.

#### **Network Management Costs**

Network management infrastructure and software solutions have been designed and built to monitor all networks operated by Digita, not multiplex by multiplex or even for the DTT network as a whole. Only a small portion of network management costs or equipment could be removed if any individual network was switched off. Due to this network management costs have to be allocated through e.g. the monitoring point system which Digita has implemented, or something equivalent.

#### **Cooling systems**

The allocation method proposed in the report is in our opinion excessively simplified. In practice, the transmitter power determines the scale and



consequent costs of cooling systems better. The existing allocation method used by Digita fulfils the causality principle as closely as reasonable.

#### Antennas

The height alone is not a sufficient allocation key for antenna and feeder cable cost allocations. The physical size of an antenna and a feeder cable are significant factors in wind/snow/ice load calculations. If a larger antenna with a good performance is installed, a smaller feeder cable and less power can be used and vice versa.

#### Shared infrastructure

The alternatives presented here are on a very general, simplified level. Traditionally Digita's customers have required allocation keys with a higher correlation to real drivers of costs to justify our prices (current use of TX power levels (as in ETV calculations) has been widely accepted as a relatively simple but accurate enough method).

#### **Comments on DTT capacity pricing principles**

The consultants have recognized the practical requirements and are in favor of Digita's current pricing principles for national DTT networks capacity pricing.

However, in regional pricing they would like to maintain a more orthodox position, when saying that only different costs per area would be justification for different prices.

Before ATV switch-off, we see that the basic logic in regional transmission services pricing is similar as presented in item 3.5.5. (prime time vs. other times of the day).

In a situation where capacity is limited, the first regional customer blocks the capacity so that it cannot be sold as a nationwide capacity any more. Most likely the first regional services will be sold at sites which are located in densely populated areas, consequently leaving unused capacity blocks to rural areas.

From Digita's customers' point of view a regional service in northern Finland should not be expensive, but a premium could be acceptable in areas of higher population coverage. Every euro earned from services in rural areas contributes to sharing of total network maintenance costs between our various customers. As long as we are not able to have dedicated, regional frequencies for regional services we can not forget the fact that selling regional services in a national network follows a different business logic.

### **Determining a WACC for Digita**

When calculating a WACC for Digita, it should be kept in mind that substitutes like Cable TV, IPTV and partly satellite have already created and in the coming few years increasingly intensify competition with Digita's terrestrial TV platform. When collecting sector betas for reference, it should also be noted that a discontinuity like ATV switch-off is not reflected in comparable companies' historical market data as we are the first ones who really switch off power from ATV networks.

### **Time span of monitoring regulated prices**

We'd like to repeat our comment already presented in our comments to the Interim Report: A calendar year is clearly a too short period to judge if a service is priced correctly or not. Digita has built DTT networks during the last four years and during that time this activity has not been very profitable due to a high level of capital expenditure and roll-out related operating expenses. When the network now is ready and most of the capacity finally is sold, Ficora should not rush into conclusions on DTT pricing. Annual reporting is another issue; routines of course have to be in place.

A strict calendar year approach would lead to rapid and repeating price changes and the final cost for a customer would be a result of ex-post calculations, either as an extra charge or an additional discount. Through such a method our well performing customers would in fact essentially carry the risk of a network operator and pay the costs of less successful customer cases.

For example in 2002-2003 Digita had a lot of free, unsold capacity in mux C, and Digita seriously considered to switch-off the mux C. In the long run this would have been a short-sighted decision and would have seriously hurt the development of the DTT in Finland. Our decision to continue was supported by Ficora. However, we should be allowed a reasonable return on the DTT in the long run, including also the losses recorded during the roll-out phase.

According to our interpretation Europe Economics consultants share our views on this when emphasizing the importance of assumptions for the future. A relevant period for monitoring the pricing would be 4-5 years, which is also used by the Finnish Energy Market Authority.

### **Next steps**

Concerning proposed next steps Digita sees the appropriate order of items to be dealt with as follows: First steps should in our opinion be (b), (c) and (d) because these affect our daily work right now. If changes in allocation methods or accounting separation currently in use (and being recorded to our company books) would be necessary, we should agree on those with Ficora as soon as possible, otherwise we have no useful data and no useful basis on any further analysis.



Digita's Separated Accounts 2004 have been already reviewed by Ernst&Young during the last few months and their report with 2004 data has been delivered to Ficora. According to the definition of an auditor's role in the Communications Market Act, E&Y have provided their opinion after a review of the practical costing and cost allocation solutions chosen by Digita. We do not see any reasons for a major redesign of our currently used Cost Accounting System as it has just been reviewed by our auditors.

From the asset valuation point of view, it should be noted that the official Separated Accounts have been prepared using HCA for all Digita's assets according to Ficora's instructions. As explained above, we do not see this as a method of communicating relevant information. Due to this we have enclosed a comparative calculation to the Separated Accounts, based on Technical Present Values as instructed in practically all Ficora guidelines, the only exception being the rules for preparing the Separated Accounts. This comparative calculation should be used when drawing any conclusions from 2004 data.

Furthermore, all the guidance received from Ficora (e.g. Instructions for creating a Cost Accounting System, latest update 28 July 2005) have given Digita (and other regulated telecommunication companies) a freedom to choose a Cost Accounting System which supports best the activities of each company. Auditor's and Ficora's role should be to monitor that the results are in line with the regulatory objectives but not to orchestrate each and every detail in systems used by various companies.

#### **Appendices (**CONFIDENTIAL**):**

1) Sent to Ficora 26 August 2005:

*- Appendix 1 to Digita's comments to the Final Report 26 Aug 2005*

*- Appendix 2 to Digita's comments to the Final Report 26 Aug 2005*

2) Enclosed to this document:

- Appendix A: Bearing point report "Valuation of Capital Base in Finnish Broadcasting Mast Business", Sept 2005

- Appendix B: Translation of TERA's document "Analyse de l'étude Europe Economics pour la FICORA Finlande", Sept 2005

- Appendix C : TERA : "Analyse de l'étude Europe Economics pour la FICORA Finlande", original document in French