

January 13, 2006

Ms. Gloria Blue
Executive Secretary, Trade Policy Staff Committee
Attn: section 1377 Comments
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, D.C. 20508

Re: Italy: Reply Comments by Telecom Italia SpA

Dear Ms. Blue,

These reply comments are filed by the Telecom Italia Group in response to the request of the United States Trade Representative (USTR) in the framework of the review by the Office of USTR of the status of compliance with international trade agreements, pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. § 3106. In particular, Telecom Italia's reply focuses on concerns raised by one party, Comptel, in the initial round of comments regarding compliance with the provisions of the WTO General Agreement on Trade in Services, and aims to address the following specific issues docketed by Comptel.

Telecom Italia is one of the world's largest fixed telecommunications operators, with approximately 26.6 million subscriber fixed-lines installed in Italy as of June 2005 (including ISDN equivalent lines). Telecom Italia also is the largest mobile telecommunications operator in Italy¹ and one of the largest in the world, with approximately 44.3 million mobile lines as of June 2005², of which 26.1 million are in Italy. The Telecom Italia Group provides leased lines and data communications services, Internet services and IT software and services. Following the merger with Olivetti, Telecom Italia also operates in the office products, and specialised application for service automation through Olivetti Tecnost. The Group's international portfolio of subsidiaries and investments includes fixed and mobile telecommunications companies in Latin America and in certain countries in Europe.

¹ On June 30, 2005 the mobile subsidiary TIM S.p.A. was merged into Telecom Italia SpA.

² Foreign lines exclude those of the consolidated companies considered discontinued operations/assets held for sale.

1. Provisioning of Interconnection on Cost-Oriented and Non-Discriminatory Terms and Conditions, and Access to Unbundled Network Elements

Comptel contends in comments dated December 16, 2005 that:

- *“The Italian Regulator has failed to carry out the obligations in the Reference Paper with respect to ensuring that a major supplier provides interconnection on cost-oriented, non-discriminatory terms and conditions, as well as access to unbundled network elements. Prices for local private lines and interexchange services in Italy remain among the highest in Europe and appear still far from being cost oriented”*

Telecom Italia submits that none of Comptel’s comments reflect the real situation for the following reasons:

Contrary to what is claimed by Comptel, the Italian Regulator “l’Autorità per le garanzie nelle telecomunicazioni” (AGCOM), has complied with both the relevant commitments made in the Reference Paper and the recommendations of the European Commission by implementing regulations that require the incumbent to provide interconnection on cost-oriented, non-discriminatory terms and conditions, as well as access to unbundled network elements. In particular, AGCOM has acted through the following decisions:

First, on June 27, 2002, upon its publication in the Italian Official Gazette, AGCOM Decision n. 152/02/CONS established that the operator with significant market power (in this case Telecom Italia) in the interconnection, leased lines (both wholesale end-to-end circuits and partial circuits) and subscriber lines (local loop unbundling) markets has to conduct its regulatory accounting based on current costs, and has to ensure the equivalence of treatment between its own retail business units/affiliates and other licensed operators in providing network services to both of them.

Second, on March 12, 2003, upon its publication in the Italian Official Gazette, AGCOM Decision 03/03/CIR introduced a network cap regime to apply to Telecom Italia for the four-year period of 2003-2006 covering the markets of interconnection, leased lines and local loop unbundling. Most of the services of the Telecom Italia Reference Interconnection Offer (RIO) (see footnote below) were included in the baskets. The parameters X had been defined by AGCOM on the basis both of accounts and forward-looking efficiency target aimed to ensure cost-oriented and decreasing interconnection rates. Those varied from 8% applied to local services, to 6% applied to metropolitan and national services, up to RPI for accessory services³. AGCOM required Telecom Italia to supply services not included in

³ Current regime

AGCOM Decision 03/03/CIR introduced a network cap regime to apply to Telecom Italia for the four year period 2003-2006 covering:

- interconnection;
- leased line part circuits;
- local loop unbundling (price cap due to start from 2004, but not implemented so far).

The services subject to the network cap are divided into five baskets:

- Basket A: Interconnection services at local exchange level, interconnection kit, interconnection links, and leased line part circuits: RPI-8% per annum
- Basket B: Interconnection services at metropolitan and single transit levels: RPI-6% per annum

baskets at cost-oriented prices, that is at their cost with a WACC return on capital employed. Furthermore, tariffs for low distance partial circuits were set at ceiling levels defined by the European Commission, while LLU monthly rental was fixed at the lowest tariff level in Europe, to a value significantly lower than its cost. The results of the application of these AGCOM decisions can be found in Telecom Italia's 2005 RIO which was submitted to AGCOM in October 2004, approved by Order n.1/05/CIR, and published in March 2005.

In October 2005, Telecom Italia submitted its 2006 RIO, in compliance with the regulatory network cap regime.

Telecom Italia would like to underscore that:

1. The supply terms and conditions for the regulated services included in Telecom Italia's 2005 RIO are among the most complete and suitable in Europe; and
2. Because, as explained, most services are included in the network cap mechanism, and some relevant services, such as local partial circuits and Local Loop Unbundling, are set at prices consistent with European levels or even, as in the case for LLU, at the best European level, we do not see any failure of our NRA in terms of ensuring cost-oriented prices.

Last, after the introduction of the European New Regulatory Framework (NRF) and after the consequent transposition of the NRF into the Italian legislation through "Il Codice delle Comunicazioni Elettroniche" in July 2003, AGCOM's market analyses in the relevant markets have led AGCOM to draft decisions which address the interconnection, leased lines and local loop unbundling services markets, which will not lead to lighter regulation on price controls and on cost orientation.

As a result of the combination of the cost orientation obligation on one hand, and the network cap on the other, the Telecom Italia RIO prices have considerably declined over the last several years. The tables in Annex A show the fixed interconnection rates in the main EU countries as of October 2005. The rates applied by Telecom Italia are within the EU average.

Contrary to Comptel's allegations, it should be noted that the access tariffs to unbundled network elements in Italy are among the lowest in Europe. The figures below

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- Basket C: Interconnection services at double tandem level, access to submarine cable stations, international conveyance (non-liberalised routes): RPI-3.75% per annum
 - Basket D: Accessory services. Charges for activation of number portability, CPS, leased line part circuits, LLU, sub-loop unbundling, access extension circuits and numeric channel service (service offered when LLU not possible): RPI-RPI per annum
 - Basket E: Access services. Monthly rental charges for unbundled copper loops, sub-loops, shared access, access extension circuits and numeric channel service.

2003: No price cap, Telecom Italia was required by the NRA to set charges based on a number of criteria, including setting charges in line with the lowest elsewhere in Europe. AGCOM approved a charge for 2003 of € 8.30/month per unbundled loop, equal to the charge in Denmark at that time.

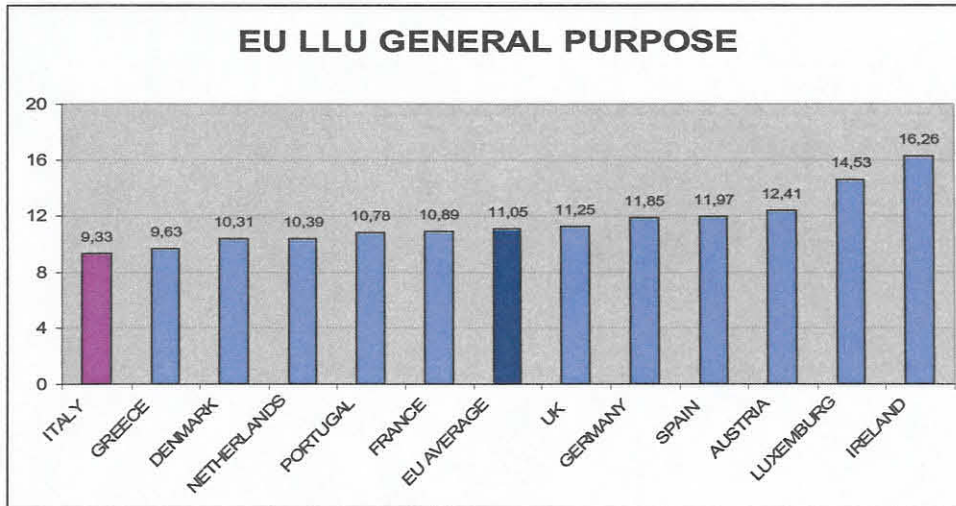
2004-2006: Price cap for Basket E due to start from 2004, but not implemented so far (see AGCOM proposals below).

Reference offer 2005

In its proposed reference offer for 2005, Telecom Italia brought forward to 2005 the prices for interconnection services estimated to apply under the network cap regime in 2006. Telecom Italia stated that this was in line with a set of commitments made to the competition authority prior to its decision in Nov. 2004 to fine Telecom Italia €152m for abuse of a dominant position in the markets for telecommunications services over fixed networks for business customers. The fine was subsequently cancelled on appeal.

AGCOM Decision 1/05/CIR on reference offer for 2005 approved the proposed charges. (Source: Cullen International)

show the monthly charges and set up fees for fully unbundled loops (active loops used to provide both voice and ADSL services) applied in Europe. Italy currently has the best practice in Europe with the lowest charges in average.



Notes: 1) The table is updated as of October 14, 2005.
2) General Purpose refers to sum of average monthly fees and set up fees of respective EU countries.

Source: Telecom Italia, Reference Unbundling Offers in the respective countries, 2005.

As far as the service levels and the non-discrimination obligations are concerned, it should be noted that SLAs are defined in the 2006 RIO, both in terms of delivery time and of penalties' application⁴. Moreover, Telecom Italia guarantees the full accomplishment of the "internal-external non-discrimination" requirement.

Comptel also claims in comments dated December 16, 2005 that:

- "(...) *the regulator has failed to implement an appropriate cost model for Telecom Italia. The current RIO for Telecom Italia is based on old audited regulatory records. No action has been taken to update the models even though equipment and other costs have declined.*"

The docketed claim combines a true statement (only old regulatory 2001 records have so far been audited by AGCOM) with a false conclusion "*The current RIO for Telecom Italia is based on old audited regulatory records*". As can easily be deduced by the above explanation of the adoption of the network cap mechanism, and as explained in detail below, Telecom Italia's 2006 RIO is not based on old audited regulatory records and is compliant with the X factors of the network cap, hence implementing an orientation towards efficient costs. Indeed, since 1998 Telecom Italia has been fully compliant with cost accounting and accounting separation obligations, as stated in DPR 318/97 and CE Rec. 8/4/1998.

According to this regulatory framework, Telecom Italia has timely produced the Accounting Separation Reports for the years since 1998, the latest being the 2004 Report.

⁴ For Telecom Italia's 2006 RIO see: http://www.wholesale-telecomitalia.it/cgi-bin/wholesale.dll/wholesale/TI_WS_GuestLogin.jsp



To conclude, Telecom Italia rejects Comptel's claim that "*The current RIO for Telecom Italia is based on old audited regulatory records.*" Indeed, the most recent Telecom Italia RIO (that of 2006) is based mostly on the network cap mechanism that ensures cost based pricing and constant price reductions, and, for the services still subject to cost plus WACC⁵ orientation, it is based on the Telecom Italia cost accounting and accounting separation report for 2004.

In light of the above, Telecom Italia fully rejects Comptel's claims in all related issues.

2. Leased Lines

a) Comptel claims in its comments dated December 16, 2005, that there is both a lack of access to, and discriminatory pricing and provisioning of, leased lines, and a failure to protect customer information. In particular, Comptel claims:

- "*Telecom Italia provisions lines requested by its affiliates first, leaving others to wait. The quality of service supplied by Telecom Italia is insufficient, but more important there is plenty of evidence that Telecom Italia provides its competitors with a quality of service below that which is offered to its own retail division.*"

As far as non-discriminatory conditions and internal and external equal treatment are concerned, on June 27, 2002, upon publication in the Italian Official Gazette, AGCOM Decision n. 152/02/CONS, required that Telecom Italia, as the operator with significant market power in interconnection, leased lines (both wholesale end-to end circuits and part circuits) and subscriber lines (local loop unbundling) markets, must ensure the equivalence of treatment between its own retail business units/affiliates and other licensed operators in providing the network related services.

The same decision specifies that:

- The provisioning of network services from Telecom Italia to its own commercial business units operating at the retail level must be offered through agreements which explicitly describe the technical & economic conditions offered. These agreements have to contain at least the clauses indicated in the same AGCOM decision, including the maximum delivery time, average provisioning time, average availability of service, maximum time for availability of service (including both wholesale end-to end circuits and partial circuits).
- The provision of network services to other licensed operators interconnected with Telecom Italia must be offered with the same service and assistance levels offered by Telecom Italia to its own sales units or its own affiliates.
- The contracting and selling of network services must be performed by entities which are different from the sales organization units offering services to end customers.
- The management of data on commercial activities or traffic of interconnected operators must be separated from the management of data for marketing purposes. Information systems dealing with data on interconnected operators must be managed

⁵ Weighted Average Cost of Capital

by personnel who are not in charge of managing marketing activities addressed to end-customers. Such data cannot be accessed by personnel from the commercial departments offering services to end customers.

- Cost accounting must reflect the evolution of the organization in compliance with the implementation of the measures described above.

Therefore, Telecom Italia's wholesale offer ensures equal treatment to other licensed operators with respect to provisioning, as well as quality assurance. The economic and technical provisioning conditions and the quality indicators contained in the orders for each network services (transport network and access network) are identical whether offered to another licensed operator or to Telecom Italia's own units.

The technical conditions on provisioning, availability and assurance are reported to AGCOM every 6 months. Reports must include a very detailed attachment of all compared values of the indicators defined in the 152/02 CONS decision, Annex C. AGCOM uses this data also to ensure that Telecom Italia is in compliance with the equal treatment obligation. Since June 2003, Telecom Italia has had to present an annual certified report by an independent auditor proving its compliance with data management obligations. In addition, the agreements signed between the internal organizational units of Telecom Italia regarding end-to-end transport services also must include at least the clauses on service levels for interconnection services as reported in the RIO as well as a table on delivery time, which must be the same as provided to third parties. Therefore, Telecom Italia is compliant with the obligation of equal treatment and non discrimination.

b) Comptel, in an attempt to show discriminatory behavior in leased lines provisioning to other competitive providers, not only claims that Telecom Italia does not provide quality assurance and gives priority to its affiliates in providing requested leased lines, but also connects the evidences of these alleged discriminatory behaviors with the fact that the Italian Competition Authority fined Telecom Italia €152 million (US\$182.3 million) in 2004 for having abused its dominant position in the market for fixed network telecommunications services for business customers. In particular, Comptel states:

- *In fact, in 2004, the Italian Competition Authority fined Telecom Italia €152 million (US\$182.3 million) for having abused its dominant position in the market for fixed network telecommunications services for business customers. One of the two types of conduct cited by the Authority was "imposing technical and financial conditions on its competitors that were less favorable than those offered to its own commercial divisions for the same services to the end-customer."*

First, Telecom Italia submits that attempting to show a relationship between the discriminatory provision of leased lines and the fine to which Comptel refers appears to be quite specious. The fine to which Comptel refers to does not pertain to the alleged claims in the wholesale Leased Lines market.

In any case it should be noted that the decision and the fine were dropped by the competent administrative court of appeal on May 11, 2005 with Decision No. 3655⁶.

⁶ http://www.giustizia-amministrativa.it/Sentenze/RM_200503655_SE.doc

Comptel also claims that:

- “ (...) competitors often experience prolonged delays in obtaining pricing from Telecom Italia. Telecom Italia, as the major supplier, has failed to provide service on a non-discriminatory basis in contravention of its obligations under Paragraph 5 of the GATS Telecom Annex.”

With reference to the above quoted claims, first it should be noted that it is not clear to which “pricing” Comptel is referring to. If Comptel is referring to the pricing conditions in regulated markets, Telecom Italia replies that there are obligations related to provisioning, pricing and service levels which are set by AGCOM and published in the related Service Level Agreements. Their infringement or wrongdoing results in fines and penalties as set forth by AGCOM⁷. Telecom Italia is fully compliant with those regulatory provisions.

Should the claim be referring to pricing in non-regulated markets, it should be said that those markets are highly competitive (hence not subject to *ex ante* regulation). Any dilatory or inefficient behavior by Telecom Italia in highly competitive markets would be detrimental to Telecom Italia business and favor competitors, therefore it would not make any sense.

3. Fixed to Mobile Termination rates

Concern about the termination rates in Italy also are raised by Comptel and AT&T in the 2006 USTR review proceeding. Comptel argues that:

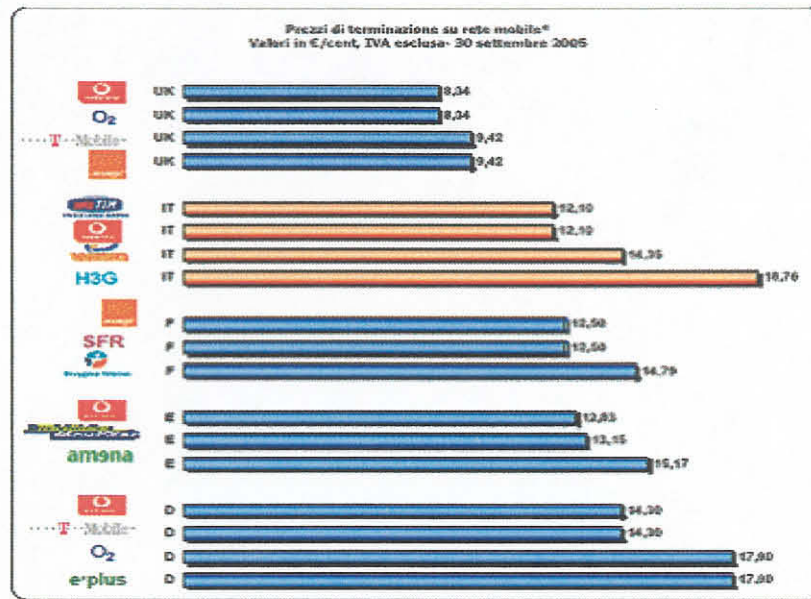
- “The mobile termination rates in Italy continue to remain high compared to the other EU countries”.

First of all, Telecom Italia would like to stress that the call termination rates in Italy are in the average of the main EU operators, as shown in the table⁸ below.

⁷ See Decision No. 711/00/CONS, Appendix B; Decision 393/01/CONS; Decision No. 304/03/CONS,

⁸ Notes:

- The Euro/GBR exchange rate is 0,677595 as of September 30, 2005
- The weighted average rates has been determined by NRAs in case of the operators designated SMP
- In case of Italy the rate of H3G has not been determined by Agcom
- In case of UK, the rates considered are those applied to 2G network (as of today, only 2G network's call termination rates are explicitly regulated by Ofcom and the 3G network's call termination rates are determined with commercial negotiations. At this initial point of 3G network development, Ofcom considers that 3G network termination is based upon the termination rates imposed on 2G networks. However, Ofcom has launched a Public Consultation on June 7, 2005 with the aim of assessing the cost of call termination on 3G mobile network and to decide if and how to intervene on these termination rates.
- In Germany the F-M call termination rates are not regulated. Indeed they are determined through the Commercial negotiations between the operators.



Source: Analysys, 2005

Moreover, in addressing the allegation raised by Comptel and AT&T, Telecom Italia submits that several factors have to be considered such as the high level of competition in EU mobile sector, the different pricing structure of mobile call termination based on the 'Calling Party Pays' ("CPP") pricing mechanism, the recent changes in the regulatory environment in the European Union and the market analysis and proposed remedies in mobile call termination market by AGCOM.

First, the highly competitive feature of the European mobile sector has led to an enormous geographic footprint and a continuous stream of product innovations in the related markets. Moreover, it should be recognized from an international perspective that European mobile termination market is becoming increasingly competitive, creating market pressure to reduce termination rates.

Second, as already stated by Telecom Italia within the FCC's Notice of Inquiry in the matter of the effect of foreign mobile termination rates on U.S. customers (IB Docket No. 04-398), mobile termination rates in Europe are determined by the structure of mobile termination market, in particular by the CPP system. CPP markets necessarily exhibit different demand conditions and therefore different pricing patterns than the mobile call termination pricing model applied in USA ("Receiving Party Pays" - RPP). Telecom Italia would like to stress again that it would be inappropriate to compare US termination prices with European termination rates in isolation, without taking into account the overall context.

Concerning in particular the mobile pricing model of Calling Party Pays, it has to be borne in mind that:

- This model has led to recognized advances in mobile penetration, often crucial to involve the biggest possible number of users. The average penetration rate of mobile

services also continues to grow, and – as reported in the 10th Implementation Report by the European Commission, is at 83% for the EU 259.

- The adoption of such a model is reflected in many national regulatory rules, hence any attempt to push for its modification for alleged anticompetitive effects should be submitted to competent international bodies, where appropriate instruments exist to solve these types of controversial matters.

The third factor concerns the recent changes in the regulatory environment in the European Union. The new regulatory framework that was required to be implemented in the Member States by July 24, 2003, defines processes that National Regulatory Authorities (NRAs) must follow, including market analysis methodology and application of appropriate remedies in the event of market failure. One of these markets is the mobile call termination market. The guidelines that have been provided by the European Commission on the analysis and selection of remedies are designed to address possible abuse of dominance should this arise.

The common regulatory framework is now in place across the EU. It addresses the mobile call termination market using a competition law based methodology. This, together with increasing competition, is having the effect of decreasing mobile call termination prices across the EU.

Last but not least, one should consider the market analysis and proposed remedies in the mobile call termination market by published AGCOM. On December 1, 2005 AGCOM notified the Commission and the other NRAs of the results of its analysis of the wholesale market for voice call termination on individual mobile networks (market 16). AGCOM previously published its draft decision on market 16 for national consultation in January 2005, in which it proposed a glide path of reductions in the mobile termination rates of Telecom Italia Mobile (TIM), Vodafone and Wind starting from June 1, 2005.

It also should be noted that on July 19, 2005 AGCOM adopted a decision imposing reductions in the mobile call termination rates of TIM, Vodafone and Wind from September 1, 2005 as a provisional measure pending completion of its analysis of market 16. As a result, the mobile call termination rates imposed on SMP operators in mobile call termination markets (including Telecom Italia Mobile - TIM) have been reduced, and are expected to decline further in the near future with a glide path as shown below:

| MNO | Current charge* eurocents/min | From July 1, 2006 eurocents/min | From July 1, 2007 | From July 1, 2008 | Cost oriented target charge by July 1, 2008 eurocents/min |
|----------|----------------------------------|---------------------------------------|----------------------|----------------------|---|
| TIM | 12.10 | 11.20 | RPI-13% | RPI-13% | 8.90 |
| Vodafone | 12.10 | 11.20 | RPI-13% | RPI-13% | 8.90 |
| Wind | 14.35 | 12.90 | RPI-16% | RPI-16% | 9.50 |

*as imposed in July 2005

Source: Cullen International, January 2006

⁹ See 10th Commission Communication on European electronic communications Regulations and market 2004.

As a result, the current regulated call termination rates in USD/min are ranging from 0.14 to over 0.17¹⁰.

In summary, Telecom Italia respectfully submits that Comptel erroneously states that the current mobile termination rates in Italy are among the highest in Europe. Telecom Italia thanks the USTR for the opportunity to submit the reply comments within the review by the Office of USTR of the status of compliance with international trade agreements, pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. § 3106.

Sincerely,


Andrea Camanzi

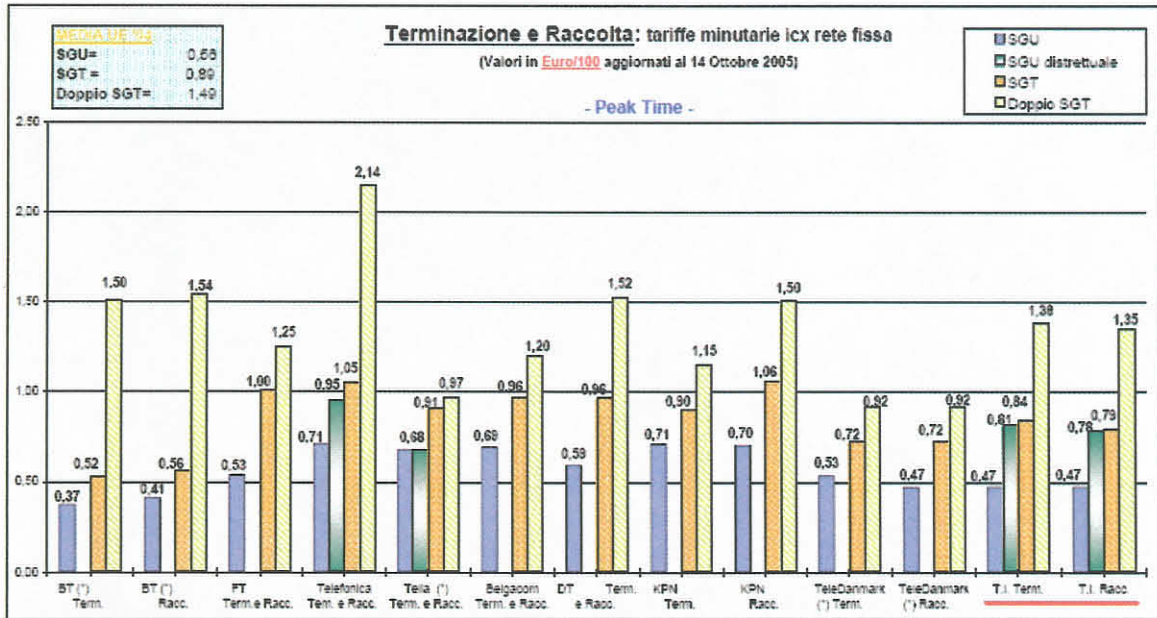
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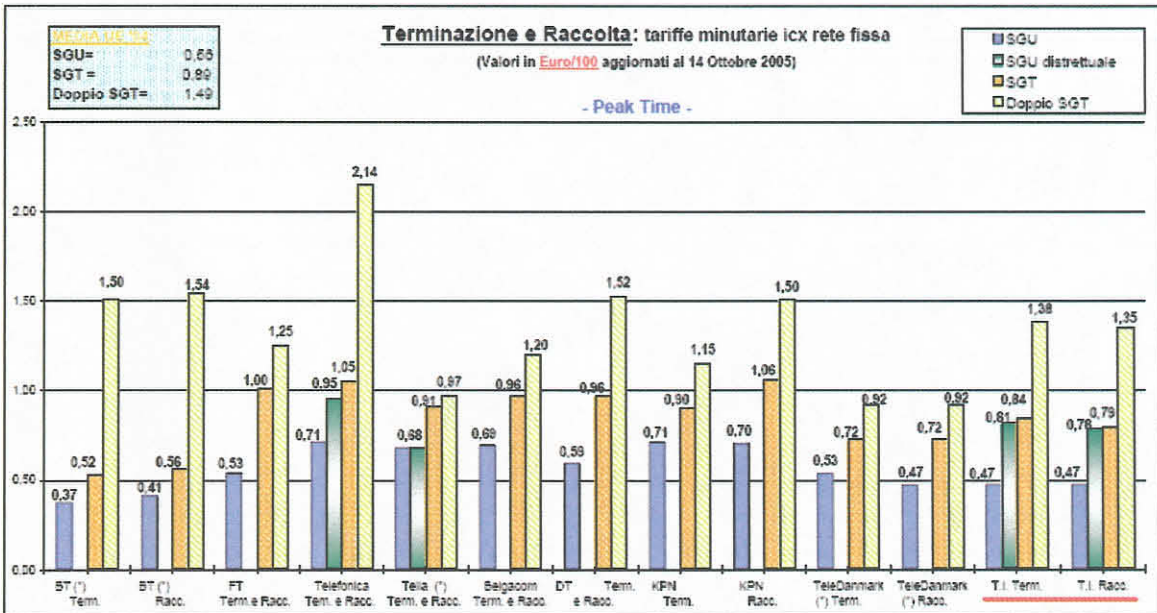
¹⁰ Exchange rate as of January 9th, 2006. H3G is excluded as it is not an SMP operator and applies non-regulated termination rates.

Annex A

Fixed Interconnection Rates (October 2005)



Nota:
 in Francia non viene offerto il servizio di RACCOLTA in doppio SGT, mentre le condizioni di TERMINAZIONE sono negoziate negli accordi d'interconnessione con un'unica tariffa su tutto il territorio nazionale. Le tariffe riportate sono quelle applicate a partire dal 1/02/04 pubblicate da FT in un documento a parte (Tarif ou double transit).
 in Belgio il servizio di RACCOLTA non viene offerto a livello di Doppio SGT
 in Italia le tariffe riportate, valide per il 2005, sono approvate da AGCOM e pubblicate nel Listino TI del 15.04.05 ai sensi della Del. 1/05/CIR.
 Valore medio UE calcolato ponderando le tariffe nazionali di terminazione con la relativa popolazione al 1.1.2004 (Fonte sito UE)
 I valori dell'Offerte di tutti i Paesi sono stati confrontati con il benchmarking prodotto da Cullen International "The Cross-Country Analysis" del 19 Agosto 2005.
 (*) Tassi di cambio medi annuali UTC 2004 per i Paesi che non hanno aderito all'EURO (valori soggetti a fluttuazione)



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