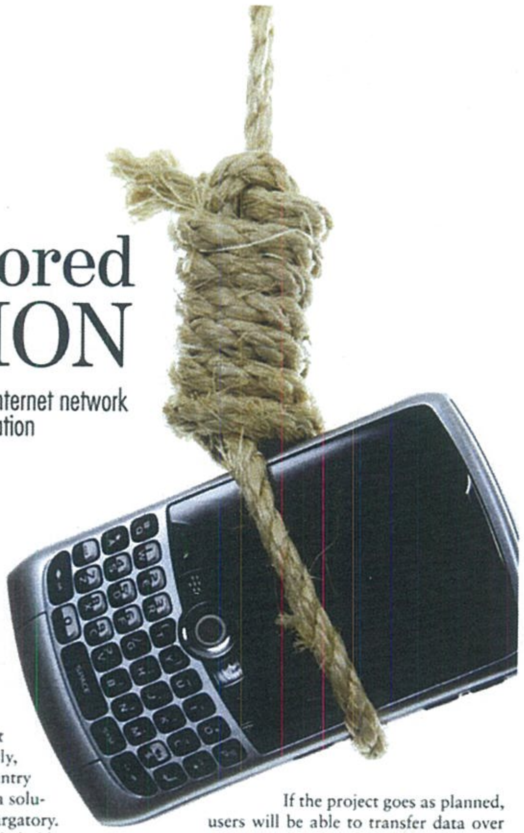
State-sponsored EXECUTION

Government stranglehold on a new mobile Internet network threatens to snuff out private sector participation



The Lebanese are in the unfortunate position of empathizing with Vladimir and Estragon, the aimless *dramatis personae* from Samuel Beckett's legendary "Waiting for Godot," over their own absurdist Internet tragicomedy. Recently, signs have emerged that the country could be on the cusp of reaching a solution to its telecommunications purgatory. But, with the usual governmental skulduggery abounding, should Lebanon's Godot actually arrive he may more resemble the Grim Reaper for the country's private internet providers.

3G in the news

On January 28, Caretaker Minister of Telecommunications Charbel Nahas announced that his ministry was undertaking a project to bring third generation (3G) mobile services to the country over a period of seven months. Third generation technology is a means of incorporating high speed Internet with mobile devices such as "smart phones," but subscribers will also be able to attach a simple device called a "dongle" to their computers and use the service the same way they currently use other wireless Internet products on the market such as the pervasive Mobi and Wise Box.

If the project goes as planned, users will be able to transfer data over mobile devices at speeds of up to 21 megabits per second (mbps). When compared to the current average speed of 0.1 mbps using the general packet radio service (GPRS), the upgrade undoubtedly constitutes nothing less than a game changer in the Lebanese Internet arena.

The projects will leapfrog the fixed digital subscriber line (DSL) Internet market, which is still waiting for a fiber-optic backbone to be built.

As part of the plan, the state-owned telecom companies Mobile Interim Company One (MIC1), managed by Orascom Telecom's Alfa, and Mobile Interim Company Two (MIC2), managed by Zain telecom's MTC Touch, will build an almost completely new network. Contracts to do so have already been signed with the Swedish company Ericsson to build MIC1's network for $36.2 million, and with the Chinese Huawei to build MIC2's network for $25.6 million. Nokia-Siemens will build the control center.

Almost immediately after the announcement the elation was palpable, with many in the media and business community heralding the upgrade as the beginning of the end of the country's Internet woes. However, those in the industry's private sector were less enthralled, fearing that the projects could lead to a complete "nationalization" of the country's already widely state-owned telecommunications sector — an understandable concern given the private sector's often contentious past with the government.

DSL's overhang

In 2006, when DSL Internet was being introduced to the market, the telecommunications ministry, then under Marwan Hamade, signed a memorandum of understanding (MoU) with private sector players, known as Data Service Providers (DSP) and Internet Service Providers (ISP), stating that the government intended to compete with them on a level playing field. Data and Internet provision is currently the only area in which the private sector is allowed to participate in the telecommunications sector.

The need for an MoU stemmed from the fact that Lebanon's telecommunications legislation (Law 431 was passed in 2002) had at that time not yet come into effect due to the fact that the institutions it mandated — the Telecom Regulatory Authority (TRA) and Liban Telecom, a government-owned body with a corporate framework that eventually is supposed to replace the telecommunications ministry — had not yet been appointed by the Council of Ministers, Lebanon's cabinet.

The MoU was also required because the government, through Ogero, Lebanon's state-owned fixed-line telecommunications monopoly operator, had an inherent competitive advantage over the private sector. At the time, Ogero owned the infrastructure needed for DSL, particularly at the "central offices" (COs), distribution centers in each neighborhood that are needed to dole out DSL to customers. Even with a legal framework in place to promote the private sector's participation in the industry, the government broke the agreement and shored up its control.

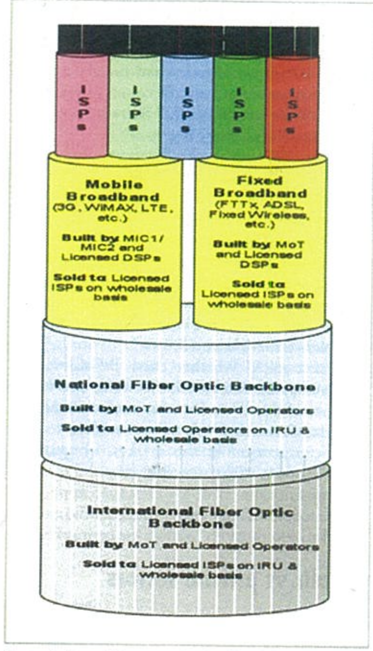
> **The private sector fear the 3G project could lead to a complete 'nationalization' of the telecom industry**

"Ogero initially started its DSL in 35 'central offices' and let the private sector [use] 34, with the one in Solidere off limits," says Imad Tarabay, secretary general of the Lebanese Telecom Association (LTA), which represents Lebanon's private-sector data and Internet providers. "Since then, Ogero expanded from 35 to 171 [COs, which] the DSPs were not allowed [to use]."

Tarabay, who doubles as chairman of Cedarcom, which owns the Mobi wireless service, explains that because Ogero knew in advance when a neighborhood was ready for DSL they would call the subscribers in the area — naturally, they already had their numbers — and offer them DSL before the private sector could have a chance to offer them the service. "They shaved everyone," he quips, slicing his hand across his desk.

According to the LTA, the result of what they call "unfair practices" caused the DSL environ-

Lebanon's prospective Internet infrastructure



Source: Lebanese Telecommunications Association.

ment to become even more lopsided in favor of the government, which they now estimate controls almost 80 percent of the market. Last month, Cedarcom and another DSP, Broadband Plus, filed lawsuits against the telecommunications ministry, stating that the companies had bought and deployed equipment around the country in preparation for DSL's launch in 2007 but were prevented from operating them by Ogero.

"The Ministry of Telecommunications [MoT] gave permits to Cedarcom to install DSL equipment in 34 exchanges (COs), issued a decision [that it would] link the 34 exchanges to [Cedarcom's] headquarters and then refrained from linking them for no reason whatsoever," says Tarabay [see graph]. "This led Cedarcom to have zero DSL clients, while Ogero has an estimated 200,000 and other Data Service Providers (DSPs) have 40,000."

When asked whether these practices were fair, Mahassen Ajam, commissioner and board member of the TRA, Lebanon's telecommunications regulator that is legally mandated to promote competition in the market, sympathizes with Tarabay. "No, it's not fair… the major rules of fair competition were never applied by the ministry." The telecom ministry did not respond to EXECUTIVE's request for comment.

Fiscal fumble

According to official figures, last year the government made more than $2 billion in revenues from the sector with 58 percent of it in the form of taxes on the consumer.

What most people don't realize is that 20 percent of the revenues that DSPs garner from their operations go to the government under the conditions of their "interim transitory licenses" that are only valid for one year, thus discouraging the DSPs from making long term investments. The DSPs also pay around $66,300 per year for the frequencies they use to transmit their Internet signal. They also pay net income taxes, dividend distribution tax, site rentals, $2,700 per 2.048 mbps of bandwidth (the government pays less than $100) and a $41 dollar installation fee for a DSL line at a customer site. The government pays practically none of these fees [see table].

In October 2010, Lebanon's four private DSPs paid $438,638 to the TRA in license fees. That figure is greater than the 25-year license fees for all four operators in Finland, where broadband Internet has been considered a human right. According to LTA, the amount of taxes they pay amounts to 59 percent of their operational revenue, a tax figure similar to that paid by citizens for telecommunications services. At least in this respect it seems the government is treating everyone equally.

The 3G hatchet

Given this fiscal disadvantage, it's a wonder to many how the private sector keeps its head above water. It has done so ostensibly because it is able to offer value added services to customers on a competitive basis. But now that 3G services are about to hit the market, they are predictably crying foul.

Introducing 3G without leveling the playing field is exactly what the telecom ministry is planning to do

Their fear is that if MIC1 and MIC2 enter the market with such a large fiscal and technical imbalance between them and the licensed service providers, there will be absolutely no way for the existing operators to survive.

Currently, licensed providers offer wireless Internet for prices of around $40 per month to cover their costs and taxation. If you remove taxation, as has happened with MIC1/MIC2, that figure becomes something like $20 per month. What's more, licensed service providers can presently offer a maximum speed of around 0.5 mbps, which is nothing close to what 3G could bring. Furthermore, MIC1 and MIC2 have an existing subscriber base of more than 2.5 million customers to draw on while the licensed providers have around 80,000. Despite the market's lopsidedness, introducing 3G without leveling the playing field is exactly what the telecom ministry is planning to do.

"We are in a dominant position, which is very normal given the size we have in the country," says Marwan Hayek, chief executive officer of Alfa, which manages MIC1 on behalf of the government. "If we had a 100 percent private license, and we were not dependent on the MoT, the same scenario would happen," he adds, stressing that the private sector maintains the advantage of being able to manipulate prices, while he has no such luxury.

"Failure to ensure fair competition between Alfa and MTC (MIC1 and MIC2) and licensed operators, given all the advantages that Alfa and MTC have, will lead to the eminent annihilation of licensed ISPs/DSPs, meaning the extinction of the private sector operators in the Telecommunication Sector in Lebanon, and in parallel, the creation of three state owned operators, which is contrary to the principles of Law 431," says Tarabay.

Public vs private sectors

Topic of comparison	State-owned operators: MoT and Ogero fixed broadband services	State-owned operators: MIC1 and MIC2, managed by Alfa and MTC. Planning 3G services	Privately owned operators: Licensed DSPs (6 operators)	Privately owned operators: Licensed ISPs (17 operators)
Cost of Internet feed	Less than $100 (2.048 Mbps)	Less than $100 (2.048 Mbps)	N/A	About $2,700 (2.048 Mbps)
Site rental cost	N/A	Fully subsidized and paid for by voice service	About $800/site average	N/A
DSL account setup fees	0	N/A	LL 62,000 per ADSL line	LL 62,000 per ADSL line
Subscriber base	800,000	2.7 million	80,000	80,000
License duration	Indefinite	N/A (They don't have a 3G license)	Yearly renewed interim transitory license since 2002	Yearly renewed interim transitory license since 2002
Services permitted by license	Voice local and international	Voice local and international, SMS, GPRS, etc. (3G not included in their license)	ADSL, wireless broadband on wholesale basis, VoIP prohibited	ADSL, wireless broadband and Internet services on retail basis. VoIP prohibited
Site availability	DSLAMs in 171 exchanges	1800 GSM sites	DSLAMs in 35 exchanges. 400 wireless sites	Access to DSP DSL in 35 sites, access to Ogero DSL in 171 sites
ADSL subscribers	200,000	N/A	40,000	40,000
ISPs interconnected with DSLAMs*	Cyberia, IDM, Terranet, Moscanet	N/A	Each DSP is connected to 1 ISP, with an exception of 1 DSP connected to 2 ISPs	Each ISP is connected to Ogero's ADSL. Some ISPs are connected to one other DSP
Licensed RF spectrum for mobile broadband	N/A	TRA has not licensed any spectrum for 3G services	1.9 & 2.5 GHz since 2004 from MoT and on interim basis since 2007 from TRA	N/A
Frequency propagation coverage	N/A	3G on 900 MHz or 2.1 GHz has better coverage vs. DSP services on 2.5 GHz, so fewer base stations and less investment will be needed	Worse coverage on 2.5 GHz than on 900 MHz or 2.1 GHz. DSPs will require more Base Stations than MIC1 and MIC2 for similar coverage. So higher CAPEX and OPEX	N/A

**DSLAM is a piece of equipment that allows telephone lines to make faster connections to the Internet. Each operator will typically install one DSLAM per Central Office.*
Source: Lebanese Telecom Association

If that comes to pass, the fate of more than 950 highly skilled employees working with the licensed providers will be put into question, according to the LTA. "What is the government asking us to do? To shut down and open businesses in another country," asks Tarabay rhetorically.

Alfa's Hayek believes that the situation is not so dire. "Even within the 3G deployment, [private sector companies] will have a role to play because, if you listen to the minister, he wants them to [be] a distribution VNO [Virtual Network Operator] type of business," he says. A VNO can take many different forms but is basically an arrangement between the owners of a telecom asset and a company whereby it performs services, ranging from complete resale with separate branding to merely offering a back office service such as billing. An MVNO (Mobile Virtual Network Operator) refers to such an arrangement in the mobile telecom market.

"[The private sector] has the right to get a long-term license"

Mobi, who have until now controlled a lion's share of the wireless Internet market, could end up out of business due to government protectionism

"In terms of the 'dream' of offering an MVNO, whether they offer it or not it doesn't mean we will let go of our rights, nor does it mean that the MVNO fixes the [fiscal] imbalance between Alfa/MTC and the Data Operators," responds Tarabay.

"There are over seven levels of MVNO and we have been dialoguing with the TRA and MoT for over a year, whether as a company or the Lebanese Telecom Association. We have never received any feedback. Negotiating and discussing an MVNO is a process that can take months and there has not even been a draft to [outline] the guidelines," he adds.

In theory, the licensed providers could opt to build their own networks with their interim licenses and compete with MIC1 and MIC2. This would cost them tens of millions of dollars, however, and be very risky from an operational continuity point of view given their temporary licenses. In the end, they would still have to get the telecom ministry's approval to install networks that would compete with the state's new 3G offering, which it plans to spend $80.3 million to build.

Bearing in mind the government's recent history of boxing out the private sector from the market, that scenario seems highly unlikely. "I hear their concerns; I wish I could do something to help [the private sector] on the regulatory front or the licensing scheme because definitely they have the right to get a long- term license," says Hayek. "We cannot help them. I wish I could but it's not in our hands."

To regulate or not to regulate?

To steer clear of any such conflict, the logical thing to do would be to place all market players on equal footing and allow them to compete against each other to drive the market forward and push prices down. The framework for such a state of affairs already exists in Law 431, whereby it assumes that all service operators will be licensed and regulated by the TRA in order to ensure fair competition.

The law, however, is rife with loopholes; when certain operators are not licensed their operations can only be regulated by the government through the MoT, and not by the TRA. Not surprisingly, the unlicensed parties in this case are the state-owned MIC1 and MIC2.

Both MIC1 and MIC2 were created in the early-2000s by the government, when Lebanon's mobile telecommunications were tipped for privatization, with the intention of being sold within a period not exceeding six months. Since then they have existed as unlicensed privately registered companies owned by the government.

"Before MIC1/MIC2 have the ability to do the 3G projects they need some type of license, because even though they are owned by the government they are privately held companies, they are SALs, they are registered and they are, at the end of the day, operators because they are invoicing," says a legal expert in public law who supports the private sector's position, speaking on condition of anonymity.

According to Minister Nahas, it is not necessary for MIC1 and MIC2 to be subject to the same licensing conditions as private operators.

"It is said that the matter requires a license, in spite of the fact that the state does not need a license and does not give licenses to itself. It is legitimate in and of itself," he said at a June 28, 2010 press conference. "The funds are part of the revenues of private companies making investments to develop operations, just as Middle East Airlines [majority owned by the Central Bank] makes investments, keeping in mind that it is state-owned."

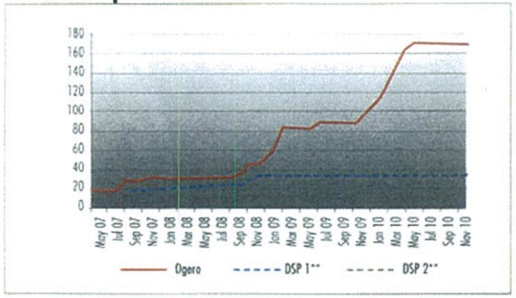
However, the Lebanese Civil Aviation Authority, Lebanon's civil aviation regulator, licenses Middle East Airlines to operate in the Lebanese market, albeit also in a monopolistic manner.

"We granted frequencies because, at the end of the day, the TRA would like to see the mobile networks developing"

Law 431 lays out the conditions for any new project to be conducted under Article 19, which dictates that a license is to be issued by the cabinet according to terms of reference prepared by the TRA for "new categories of licenses for providing public telecommunications services."

The law also states that the TRA is to issue licenses for "Internet services," and "data services," both of which apply to the 3G projects. The issue of licenses is particularly divisive for several reasons; licensed operators are subject to TRA regulations, meaning that the MoT would exercise less control over these entities. This also means that these entities must conform to TRA regulations that pass from the TRA to the telecom ministry and are then forwarded to the Majlis Shura, or the State Council, Lebanon's highest judicial authority. There they are ratified and enacted into law upon publication in the Official Gazette.

Ownership of DSLAMs*



*Source: LTA. **DSP (Digital Seice Provider) '1' and '2' are LTA members*
**DSLAM is a piece of equipment that allows telephone lines to make faster connections to the Internet. Each operator will typically install one DSLAM per Central Office.*

Another reason that licensing is crucial in Lebanon is because the TRA specifies the spectrum a provider can use to offer a service. Spectrum is a specific range of frequencies, measured in hertz, that all telecommunications services — including radio, TV and Internet — need to use to transmit signals.

Hence, if MIC1 or MIC2 are granted spectrum, which they have been, by law they should be licensed and the process should be conducted by the TRA. Indeed, the last time these two companies required spectrum to expand their mobile networks and add capacity for more subscribers in 2008, the TRA allocated it to them. At the time, the cabinet approved the expansion and it was published in the Official Gazette, which confirmed that the TRA was the sole entity empowered to grant spectrum. Then, in December 2009, under the current minister's tenure, they were again granted spectrum by the TRA.

In these cases, however, the TRA decided to grant the frequencies without licenses. "We granted frequencies because, at the end of the day, the TRA would like to see the mobile networks developing," says Ajam. "We didn't go into the legal aspect of being licensed or not. Now we have the same situation with 3G," she says, adding that if they receive a request from either the minister, MIC1 or MIC2, they will follow the same course. "We will not take a stand against the interests of the country. You have to split things between the country's needs and the needs of market dynamics."

With 3G capabilities, Smartphones will be able to provide what others in Lebanon cannot: speed

The minister's missing policy

The minister can legally maintain that he has the right to uphold the regulations he chooses because he is also empowered by the law to set the "general rules for the regulation of telecommunications services in Lebanon," according to Law 431.

The minister prior to Nahas, Gebran Bassil, who is from the same party, actually published a policy paper setting "General Rules for Regulating the Telecom Market," whereby he advocated issuing long-term licenses to existing service providers, as well as to MIC1 and MIC2, in addition to introducing 3G. As such, the current situation is difficult to frame as being purely politically motivated.

Despite previously stating that he would issue his own policy, Minister Nahas has since reneged and removed the policy paper from the ministry's website. Last December his advisor told Executive that the only policies the minister would call for would be lower pricing and an end to the state monopoly over telecommunications.

"The policy of the ministry is not a matter of paper, it is a matter of practice," said Nahas in November at a press conference.

In any case, the TRA can hardly afford to anger the minister. Their budget comes from the treasury and has to have the minister's approval before they can receive it. This year the staff at the TRA went four months without receiving pay because the ministry did not approve their budget.

Who is significant?

Another way the TRA could impose fair market competition in the upcoming 3G market is by applying the already legal "Significant Market Power" (SMP) regulation, which is designed to enforce a competitive playing field between large corporations in a particular industry.

MIC1 and MIC2 would certainly qualify as such in the 3G Internet market. The regulation protects against cross-subsidizing services, such as using a voice market to leverage data customers, a likely practice if 3G is given solely to MIC1 or MIC2. Again, however, the issue comes full circle. "You can use it when someone is licensed, [but] the MoT is not and neither is MIC1 or MIC2. So the legal approach is very tough," says the TRA's Ajam. To issue its own licenses the TRA needs a "licensing regulation," which it has forwarded to the ministry to send to the State Council. A resolution has yet to occur and the regulation is now collecting dust. "To go [directly] to the State Council there needs to be a conflict and the ministry is not issuing its own licenses, hence there is not conflict," says Ajam. "If they do give their own licenses then we will go to the State Council and wait for its decision."

"You have to split things between the country's needs and the needs of market dynamics"

Taking care of business

It is worth noting that the contracts signed by the telecommunications ministry were done so when the cabinet was in "caretaker mode," after he and others resigned from the cabinet on January 12. The legal debate over ministers' powers while they are "caretakers" is an open one.

"Administrative law is in essence not a written law. The principles of administrative law are prescribed by the practice and by the decisions of the State Council," says the legal expert. "Caretaker status is a restrictively interpreted concept which talks about making sure that the usual basic everyday business carries on. When the minister is either empowered by the Council of Ministers or parliament to do something prior to entry into the caretaker period it would be normal for the minister to go on with the process of doing so."

The lawyer agreed that the minister had the right to start the tendering process but deemed that the issuance of purchase orders and signing of contracts were beyond the purview of caretaker ministers.

Alfa's Hayek confirmed that the negotiations with vendors occurred subsequent to the government's collapse but shifted the burden of proof as to whether this action is legal away from his company. "We don't really question the legality of such actions or steps taken by the government because it's their worry, not ours," he said. Still, Minister Nahas believes the contracts are "100 percent legal."

"Construction and equipment are among the ministry's normal tasks, in addition to the fact that this operation began before the government's resignation," he said on January 28. "It is incumbent on the telecommunications minister to not stop natural work that is part of two private companies' operations, especially if they are state-owned. It is not permissible for public ownership to be an obstacle to the people's service."

"One hand cannot clap by itself. We need all the concerned parties, especially the decision makers, to be involved in this, otherwise no one will succeed"

Land of no law

Executive has learned that several members of the private sector are preparing to file lawsuits against the MoT in response to the announcement of the 3G projects. This move follows letters sent to both Caretaker Prime Minister Saad Hariri and Prime Minister Designate Najib Mikati, asking them to remedy the situation.

As far as the ministry is concerned, however, there is little to worry over, as Minister Nahas has stated, Law 431 serves as little more than a recommendation.

"Law 431 makes its application dependent on the fulfillment of its conditions," said Nahas last year. "This law is still inapplicable because its conditions are not completely fulfilled. This matter is clearly stipulated in one of the law's clauses." Indeed there are several clauses that refer to the applicability of the law, starting with Article 51, which states that previous legal and regulatory provisions remain effective until law goes into effect. Article 52 states that "technicalities regarding the implementation of the present Act [Law 431] shall, if needed, be determined by the Council of Ministers upon the proposal of the competent Minister."

By default the minister has the power to assess what is needed. According to the legal expert, since the TRA was appointed by the Council of Ministers upon the request of a minister preceding Nahas, its functions and prerogatives are applicable. That would mean that the TRA can legally issue regulations, such as the licensing regulation that the minister is keeping from reaching the State Council. Ironically, he is empowered to do so by the very law that he deems inapplicable.

"We respect the point of view of the minister, however the TRA has been appointed in March 2007 as a direct application of Law 431, so this means that Law 431 is in effect," says the TRA's Ajam. "We will defend the TRA, the TRA's role and the law and we will continue to assume our responsibilities as defined in Law 431."

Uncertain future

Whether the issue ever gets to the State Council is uncertain. Until then the 3G project is moving forward, as are the cases against the ministry and efforts to assemble a new cabinet that may see the present minister stay or go. Whatever the result, the contentious disputes over the basic structure of the telecommunications market is putting into serious doubt on the future of the country's Internet reform.

"One hand cannot clap by itself," says Ajam, recounting an old Arabic proverb. "We need all the concerned parties, especially the decision makers, to be involved in this, otherwise no one will succeed — not us, not the private sector and not the country."